Supreme Court, U.S.
FILED

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No. _____ OFFICE OF

In The

Supreme Court of the United States

THE STATE OF CALIFORNIA, et al.,

Petitioners,

v.

GEORGE E. SCHULMAN,

Chapter 7 Trustee,

Respondent.

On Petition For A Writ of Certiorari
To the United States Court of Appeals
For the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Under the longstanding rule of *Gardner v. New Jersey*, 329 U.S. 565 (1947), the filing of a proof of claim by a State in a bankruptcy proceeding does not affect the State's Eleventh Amendment immunity other than to confer jurisdiction to determine issues involving proof, allowance and distribution of the State's claim. Under this Court's recent Eleventh Amendment jurisprudence, may a federal court find a broad, implied waiver of sovereign immunity under such circumstances, beyond the holding of *Gardner*, and allow a suit against an unconsenting State that is not in the nature of defensive recoupment to the State's claim?

LIST OF PARTIES

The Petitioners seeking review of the judgment of the Court of Appeals for the Ninth Circuit are the State of California; the California State Water Resources Control Board; the California Underground Storage Tank Cleanup Fund; and John P. Caffrey, James M. Stubchaer, Mark Del Piero, Mary Jane Forster, and John W. Brown, duly appointed members of the State Water Resources Control Board.

The Respondent is George E. Schulman, Chapter 7 Trustee for the bankruptcy estates of Gary Lazar, Divine Grace Lazar, California Target Enterprises, Inc., Alameda Management Company, Inc., Liberty Marketing Company, Inc., P & M Service Stations, Inc., Pronto Marketing Company, Inc., Mission Marketing Group, Inc., Good Guys Lube N' Tune, Inc., Challenge Marketing Co., Inc., and California Target Supply, Inc.

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PETITION FOR WRIT OF CERTIORARI

Petitioners State of California, California State Water Resources Control Board, California Underground Storage Tank Cleanup Fund, John P. Caffrey, James M. Stubchaer, Mark Del Piero, Mary Jane Forster, and John W. Brown respectfully pray that a writ of certiorari issue to review the opinion and judgment entered by the United States Court of Appeals for the Ninth Circuit on January 12, 2001.

OPINION BELOW

The decision of the United States Court of Appeals for the Ninth Circuit is reported at 237 F. 3d 967 (9th Cir. 2001) and is printed in the Appendix ("App."), *infra*, at pp. 1-39. The orders of the Bankruptcy Court and the District Court are reprinted in the Appendix, *infra*, at pp. 40-120. The order denying the Petition for Rehearing and Suggestion for Rehearing En Banc is reprinted in the Appendix at pp. 121-122.

JURISDICTION

The Court of Appeals for the Ninth Circuit issued its opinion on January 12, 2001. The order denying rehearing and the suggestion for rehearing en banc was filed April 20, 2001. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED (set forth verbatim in Appendix, *infra*, pp. 123-125)

U. S. Const., Amend. XI

11 U.S.C. § 106(b)

11 U.S.C. § 704(1)

28 U.S.C. § 1452(a)

Rule 13(a), Federal Rules of Civil Procedure

Cal. Health & Safety Code §§ 25299.10 *et seq.* (pertinent provisions of which are reprinted in the Appendix, *infra*)

STATEMENT OF THE CASE

1. Introduction

The immunity from suit held by the separate States, often referred to as the States' Eleventh Amendment immunity, is "a fundamental aspect of the sovereignty which the States enjoyed before the ratification of the Constitution, and which they retain today." *Alden v. Maine*, 527 U.S. 706, 713 (1999). This immunity serves the dual purposes of "preven[ting] federal court judgments that must be paid out of a State's treasury" and avoiding the "indignity of subjecting a State to the coercive

process of judicial tribunals at the instance of private parties." *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 58 (1996) (quoting *Hess v. Port Authority Trans-Hudson Corporation*, 513 U.S. 30, 48 (1994) and *Puerto Rico Aqueduct & Sewer Auth. v. Metcalf & Eddy*, 506 U.S. 139, 146 (1993)). In the decision below, the Ninth Circuit subordinated this essential attribute of sovereignty and, instead, has given primacy to lesser, non-constitutionally-based interests of judicial economy and bankruptcy law.

Under *Gardner v. New Jersey*, 329 U.S. 565, 573-574 (1947), a proof of claim filed by a State in a bankruptcy proceeding operates only as consent by the State to the bankruptcy court's determination of the issues of "proof, allowance and distribution" regarding that claim. That consent, the Court held, necessarily involves resolution of the defenses raised by the debtor, and the assertion of such defenses does not change a suit filed by the state into one filed against the state so as to trigger application of the Eleventh Amendment.

In three other cases, *United States v. U.S. Fidelity & Guaranty Co*, 309 U.S. 506 (1940), *United States v. Shaw*, 309 U.S. 495 (1940), and *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505 (1991), this Court applied that principle in the context of counterclaims, and held that only counterclaims that are in the nature of recoupment may be heard in connection with a suit filed by a governmental entity. Such claims are allowed precisely because recoupment is "in the nature of a defense." *Bull v. United States*, 295 U.S. 247 (1935). As the *Oklahoma Tax* case made clear, the mere fact that the two claims have some factual or legal relationship to each other does not establish the necessary waiver by the government, absent a showing of

actual consent.

Despite these well-established principles, there is conflict and uncertainty among the circuits as to whether those same principles should be applied in the bankruptcy context so as to limit the scope of the counterclaims that may be filed in response to the proof of claim filed by a State. In a decision that conflicts with holdings from the First and Seventh Circuits, the Ninth Circuit has adopted a far more expansive view of waiver than allowed under this Court's prior decisions.

The Ninth Circuit's ruling, moreover, ignores the strict guidelines for waivers of sovereign immunity reaffirmed by this Court in *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Bd.*, 527 U.S. 666, 675-682 (1999). Such waivers must be based on a clear and unequivocal declaration by the State, must be completely voluntary, and can neither be constructive nor implied. Where this standard is not met, a finding of waiver compromises a State's sovereignty and subjects it to a judgment at the instance of private parties that must be paid from the State's treasury.

Certiorari is essential to preserve the States' constitutionally-based sovereignty against efforts by debtors and trustees to use bankruptcy as a means of avoiding the existing limitations on federal court jurisdiction over claims against a State. Nothing in the Constitution nor the Bankruptcy Code warrants application of a different standard of waiver in such cases than that applicable to other suits against a State.

2. Background

Respondent George E. Schulman is the Chapter 7 Trustee in the bankruptcy cases of Gary and Divine Grace Lazar and their corporate entities. The Lazars owned and operated approximately 200 retail gasoline stations. They pleaded *nolo contendere* to charges of conspiracy and falsification of underground storage tank test results and, in 1995, were sentenced to eight years in prison and fined more than $400 million for their environmental crimes. The Lazars and their companies filed for bankruptcy in July 1992.

Prior to filing for bankruptcy, the debtors submitted claims to the State Water Resources Control Board (the "State Board"). These claims sought payment from the State Underground Storage Tank Cleanup Fund ("Fund")[1] for costs the debtors allegedly incurred, or estimated would be incurred, in cleaning up the tank leaks. The State Board denied these claims, in part, because the debtors' falsification of tank tests violated Fund eligibility laws.

In March 1996, the Trustee filed a petition for writ of mandamus against the State Board in state superior court seeking an order requiring the State Board to pay these claims, which amount to over $4 million. Eight days later, the Trustee removed the mandamus action to the United States Bankruptcy Court for the Central District of California pursuant to 28

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1. The State Board administers the Barry Keene Underground Storage Tank Cleanup Trust Fund Act, Calif. Health & Safety Code § 25299.10 *et seq.* Under these state statutes, eligible owners and operators of underground storage tanks may apply for reimbursement from the Fund for the costs of cleanup work taken in response to leaks from their tanks.

U.S.C. § 1452.

3. The Proceedings Below

After the Trustee removed his mandamus action to bankruptcy court, the State Board immediately asserted its sovereign immunity and filed a motion for remand to state court. The bankruptcy court denied the State Board's motion. The court found that the State Board had waived its sovereign immunity, based, in part, on the fact that two other state agencies – the State Controller and the State Board of Equalization – had filed proofs of claim in the bankruptcy proceeding, some portion of which were for fees owed by the debtors to the Fund.

The State Board appealed the denial of its motion for remand to the United States District Court for the Central District of California. On October 1, 1997, the district court affirmed the bankruptcy court's denial of that motion.[2]

On appeal, the United States Court of Appeals for the Ninth Circuit upheld the district court's order affirming the denial of the State Board's motion to remand the mandamus action to state court. It concluded that the bankruptcy court had jurisdiction to hear this suit not because the State had expressly consented to being sued, but because the State had waived its

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2. The district court did not reach the issue of waiver of sovereign immunity because it ruled that the Fund was not an "arm of the State" entitled to assert Eleventh Amendment immunity. App. 100-103. In the appeal to the Ninth Circuit, this finding was reversed, thereby requiring that the Ninth Circuit address the alternate grounds for affirming the district court – asserted waiver of the Eleventh Amendment.

immunity by filing a claim for the unpaid fees. App. pp. 15-25. There was no finding by the Ninth Circuit that determination of the Trustee's mandamus action was necessary in order to adjudicate the merits of the State's proofs of claim.

The State Board's Petition for Rehearing and Suggestion for Rehearing *En Banc* was denied on April 20, 2001.

REASONS FOR GRANTING THE WRIT

I. THERE IS UNCERTAINTY AND CONFLICT AMONG THE CIRCUITS ON AN ISSUE CRUCIAL TO THE STATES' SOVEREIGN IMMUNITY

The Eleventh Amendment to the United States Constitution provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

The Eleventh Amendment bars suits in federal court against a State by its own citizens as well as by citizens of another State. *Edelman v. Jordan*, 415 U.S. 651, 662-663 (1974).

Thus, the Eleventh Amendment would plainly apply to

the Trustee's suit absent a showing of consent by the State.[3] Here, there was no actual consent by the State, because it asserted its immunity at the earliest possible moment and has made every effort since then to have this matter removed from the federal courts. Appendix, *infra*, p. 25, n.14.

The Ninth Circuit acknowledged that, under *Gardner*, the filing of a proof of claim by a State in bankruptcy court confers jurisdiction over the State to adjudicate only that claim and the defenses and objections thereto. The Ninth Circuit asserted, however, that the extent to which the filing of a proof of claim constitutes a waiver of Eleventh Amendment immunity is "uncertain," and that the circuits "have not achieved consensus on the proper rule." Appendix, *infra*, pp. 16-20.

The precise question posed by the court of appeals was whether the *Gardner* rule should be seen as the limit of the bankruptcy court's jurisdiction over a nonconsenting State or, instead, as the threshold for finding a broader waiver of sovereignty under a more "liberal" standard. It concluded that the proper standard for this "waiver" should be the "increasingly liberal" standard applied to compulsory counterclaims under Rule 13(a) of the Federal Rules of Civil Procedure. App., pp. 21-24. This conclusion – that the standard for finding a waiver of sovereign immunity should be increasingly liberal – conflicts with this Court's decisions and those of other circuits.

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3. The Ninth Circuit did not rely on the argument that the attempt to abrogate state immunity, found in 11 U.S.C. § 106(b), is constitutional, but rested its decision solely on the ground of waiver.

Despite the clarity of this Court's prior holdings in *Gardner* and the *U. S. Fidelity & Guaranty Co.* line of cases (see Introduction), the lower courts are split on the applicability of those precedents to bankruptcy cases. The First and the Seventh Circuits have properly viewed the *Gardner/U.S. Fidelity & Guaranty* Co. rule as the limit of a bankruptcy court's jurisdiction over a State that has filed a proof of claim in a bankruptcy proceeding. *Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico*, 244 F.3d 241, 244-245 (1st Cir. 2001); *Jones v. Yorke (In re Friendship Medical Ctr., Ltd.)*, 710 F.2d 1297 (7th Cir. 1983). In *Jones v. Yorke*, the court, citing *Gardner*, said that "the limited waiver of sovereign immunity created by the filing of the claim extends only so far as considering the objections of other parties to the claim." 710 F.2d at 1300-1301. The Seventh Circuit interpreted this test as permitting only actions against the State that were deemed "necessary" to adjudicate the State's claim – *e.g.* to decrease the amount claimed by the State or affect the legal basis for the State's claim. *Id.* at 1301.

In the more recent case of *Arecibo Community Health Care, Inc.*, the First Circuit cited this Court's principles on waiver in *College Savings Bank* and found that a "deemed" waiver of a State's immunity[4] violates the Eleventh

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4. Section 106(b) of the Bankruptcy Code, 11 U.S.C. § 106(b), provides that a governmental unit filing a proof of claim in bankruptcy is "deemed" to have waived sovereign immunity for any and all claims against the State arising out of the same transaction or occurrence as the State's proof of claim. This provision, in which Congress purports to set forth the circumstances that will result in a waiver, is of doubtful validity. "Forced waiver and abrogation are not even different sides of the same coin – they are the same side of the same coin." *College Savings Bank*, 527 U.S. at 683.

Amendment if it extends beyond the defenses allowed under *Gardner*. *Arecibo*, 244 F.3d at 245. *Arecibo* concluded that a waiver of sovereign immunity based upon a State having filed a proof of claim is no different than a "constructive waiver," which this Court struck down in *College Savings Bank*. It is neither "altogether voluntary" nor unequivocally declared by the State. *Id.*

In other contexts, several Circuits have agreed that the defense/recoupment standard is the outer limit of those counterclaims that may be heard in response to a suit filed by a governmental entity. *See, e.g., In re Dept. of Energy Stripper Well Exemption Litigation (Anadarko Prod. Co. v. New Mexico)*, 956 F.2d 282, 285 (Temp. Emerg. Ct. App. 1992) (state did not waive immunity to suit challenging company's duty to pay into escrow fund when it requested payment from that fund; case is mirror image of facts here); *Miller v. Tony & Susan Alamo Foundation*, 134 F.3d 910, 916 (8th Cir. 1998), *United States v. Forma*, 42 F.3d 759, 765 (2nd Cir. 1994); and *United States v. Murdock Machine & Eng. Co.*, 81 F.3d 922, 930-931 (10th Cir. 1996). Indeed, even the Ninth Circuit in *Chemehuevi Ind. Tribe v. Cal. St. Bd. of Equal.*, 757 F.2d 1047 (9th Cir. 1985), *reversed on other grounds*, 474 U.S. 9 (1985), held, in a case presaging the *Oklahoma Tax* case, that a sovereign Indian tribe's initiation of a suit against a state for declaratory and injunctive relief did not constitute consent to the state's counterclaim, even though this counterclaim dealt with the same taxes at issue in the tribe's claim.

Contrary to this limited position on the scope of allowed

counterclaims, the Tenth Circuit adopted a far broader view of the waiver arising from a State's filing of a proof of claim in a bankruptcy case. It purported to find a waiver with respect to any claim arising out of the "debtor's business," regardless of whether the determination of such a counterclaim was truly a defense to the State's own claim or was necessary to adjudicate the State's claim. *Wyoming Dept. of Transportation v. Straight (In re Straight)*, 143 F.3d 1387, 1389-1392, *cert. denied* 525 U.S. 982 (1998). In doing so, the Tenth Circuit adopted an extraordinarily broad notion of "same transaction or occurrence." Such an all-encompassing standard plainly goes far beyond the defensive recoupment that this Court has previously sanctioned – and, indeed, is inconsistent with the analysis that the Tenth Circuit itself had previously used under the Bankruptcy Act in *Murdock Machine*, *supra*.[5]

In the decision below, the Ninth Circuit elected to join the Tenth Circuit in extending the rules for waiver of state sovereign immunity beyond those purely defensive matters sanctioned by the *Gardner/U.S. Fidelity & Guaranty Co.* line of cases. This view cannot be reconciled with that of the circuits that have applied the traditional rule both in and outside of the bankruptcy context. Certiorari is needed to resolve this conflict, to provide guidance to the lower federal courts, and to

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5. The Fourth Circuit's position is unclear. In *Schlossberg v. Maryland (In re Creative Goldsmiths)*, 119 F.3d 1140, 1148 (1997), it referred to the debtor's right to assert compulsory counterclaims, but also described this as the debtor's right to assert its defenses to the state's action. The latter is a correct statement of what is allowed under *Gardner*, while the former could be construed to go further along the lines of the Tenth Circuit's standard. As such, it illustrates the lack of clarity in the lower courts on this issue.

ensure that bankruptcy is not treated as an exception to the sovereign immunity standards applicable elsewhere in the law.

II. THE NINTH CIRCUIT FAILED TO FOLLOW THIS COURT'S PRECEDENT WITH RESPECT TO WAIVERS OF SOVEREIGN IMMUNITY

As noted above, the Ninth Circuit and the other circuits that have taken the rules for waiver of sovereign immunity beyond *Gardner* have done so by applying the Rule 13(a) "same transaction or occurrence" standard. They have done so, however, without the necessary sensitivity to the fact that the purpose of Rule 13(a) is not to preserve the States' sovereignty, but rather to promote judicial economy. The inquiry into what claims may be asserted defensively against a State by way of recoupment is a distinct and narrower analysis from that undertaken under Rule 13(a). Jurisdiction over a sovereign premised on the compulsory counterclaim provisions of Rule 13(a) is constitutionally impermissible. *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505, 509-510 (1991). The Ninth Circuit itself has described the provisions of Rule 13 as "congressional enactments unrelated to immunity" and unworthy of being the basis for a waiver of constitutional sovereignty. *Chemehuevi*, *supra*, 757 F.2d at 1053.

The *Oklahoma Tax* case is not a bankruptcy case, but the force of its reasoning is equally compelling here. The Potawatomi Tribe filed suit in federal court to enjoin the Oklahoma State Tax Commission's attempt to collect state taxes on sales of cigarettes on land held in trust for the Tribe. The State counterclaimed for injunctive relief and to enforce its $2.7 million assessment for taxes that the Tribe allegedly owed.

On certiorari, this Court held, on the authority of *U.S. Fidelity & Guaranty Co.*, *supra*, that

> a tribe does not waive its sovereign immunity from actions that could not otherwise be brought against it merely because those actions were pleaded in a counterclaim to an action filed by the tribe.

Oklahoma Tax Commission, 498 U.S. at 509. The Court reached this result in spite of the close legal and factual relationship between the action brought by the Tribe – to enjoin the collection of cigarette taxes – and the counterclaim by the State to enforce the collection of such taxes and to recover the taxes owed by the Tribe.

The Ninth Circuit departed even further from this Court's precedent when it utilized an "increasingly liberal" test for determining if the Trustee's mandate action was related to the same transaction as the State's claim, (*see* Appendix, *infra*, p. 24); the court held that merely because both the State's claim and the Trustee's suit against the State involved the Underground Storage Tank Cleanup Fund, the State had waived its immunity from the Trustee's suit, even though the applicable facts and law were different and the two matters could be decided without any necessary reference to each other.

Contrary to the Ninth Circuit's view, "liberal" rules of interpretation have no place in constitutional jurisprudence regarding sovereign immunity. In *Edelman v. Jordan*, 415 U.S. 651 (1974), this Court said that "[c]onstructive consent is not a doctrine commonly associated with the surrender of constitutional rights" and waiver will only be found where

stated "'by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction.'" 415 U.S. at 673 (quoting *Murray v. Wilson Distilling Co.*, 213 U.S. 151, 171 (1909). *Atascadero State Hospital v. Scanlon*, 473 U.S. 238, 241 (1985), followed *Edelman* and held that the test for determining whether a State has waived its immunity from federal court jurisdiction is "a stringent one."

In *College Savings Bank*, this Court reaffirmed the rules derived from its prior decisions for determining whether a State has waived its sovereign immunity from suit. 527 U.S. at 675-76. Applying these appropriately strict standards, the Court rejected the notion that a "constructive waiver" could be found based on the State engaging in Commerce Clause activities. As this Court explained, the point of requiring a clear and unequivocal declaration of waiver "is to be certain that the State in fact consents to suit." 527 U.S. at 680. *College Savings Bank* held that waivers must be "altogether voluntary," "unequivocally expressed" and based on a "clear declaration" by the State. 527 U.S. at 675-76. The Ninth Circuit's assertion that it may utilize an "increasingly liberal" standard in determining waiver flies in the face of an unbroken line of cases dating back for almost a hundred years demanding the application of a stringent standard.

A waiver that is implied from the act of filing a proof of claim violates every principle articulated in *College Savings Bank*. It is neither a "clear declaration," nor an "unequivocal expression," that the State is consenting to be sued in federal court. Moreover, it is indistinguishable from the doctrine of "constructive waiver" struck down in *College Savings Bank*. Indeed, because it results from the filing of a proof of claim –

the only alternative offered by the Bankruptcy Code to a State that possesses a rightful claim against the bankrupt debtor's estate – such a waiver is a great deal less "voluntary" than the conduct addressed in *College Savings Bank*.

The issuance of a writ of certiorari is necessary to provide guidance to the lower federal courts and clarify that the rules for waiver of Eleventh Amendment sovereign immunity are equally applicable in the bankruptcy context.

III. THE RULES FOR WAIVER OF SOVEREIGN IMMUNITY ARE AN ISSUE OF NATIONAL IMPORTANCE TO THE STATES

A State or state agency may become involved in a bankruptcy case in a number of ways, the most common being the filing of a proof of claim for unpaid sales taxes, unemployment and workers' compensation taxes, ad valorem property taxes, franchise taxes and state income taxes.[6] Indeed, "[m]any states, faced with mounting budgetary restrictions and monetary losses, are becoming increasingly active creditors in bankruptcy cases, and routinely file claims."[7]

A State's interest in retaining its constitutional right to sovereign immunity runs counter to the bankruptcy court's desire to deal with all issues affecting the debtor's estate in one forum. Moreover, the thrust of the Bankruptcy Code is directed towards maximizing the debtor's estate so that creditors' claims

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6. Patricia L.Barsalou, *Defining the Limits of Federal Court Jurisdiction over States in Bankruptcy Court*, 28 St. Mary's L. J. 575, 592 (1997).

7. *Id.*

can be paid. *See, e.g.*, 11 U.S.C. § 704(1). "In contrast to cases in other areas of the law, bankruptcy cases have a preferred outcome . . . one which looks to the needs of the debtor and its rehabilitation."[8]

A State, representing the interests of its citizens and the state treasury, is pitted not only against the debtor and/or the trustee, but also against all the other creditors who hope to get some return on their individual claims. For these reasons, bankruptcy courts would naturally prefer to find a broad waiver when the State files a proof of claim.

Ignoring this Court's pronouncements on the primacy of the States' sovereignty, however, certain lower federal courts have used a State-filed proof of claim as a vehicle to overcome the State's immunity from suit and thereby achieve certain Article I bankruptcy goals that are not of constitutional dimension. Although the States have a strong interest in participating in bankruptcy cases in order to protect their fiscal interests, they should not be required to unnecessarily surrender a portion of their sovereignty in doing so. "When a State asserts its immunity to suit, the question is not the primacy of federal law but the implementation of the law in a manner consistent with the constitutional sovereignty of the States." *Alden v. Maine*, 527 U.S. at 732. This principle applies with equal force when determining the reach of a bankruptcy court's jurisdiction over a private party's suit against a State.

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8. Karen Cordry, *Bankruptcy After Seminole: Still Searching for an Escape*, No. 11 NAAG Nat'l Envt'l Enforcement J. 3 (Dec. 1998/ Jan. 1999).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re Gary Lazar; Divine Grace Lazar; California Target Enterprises, Inc.; Alameda Management Company, Inc.; Liberty Marketing Company, Inc.; P & M Service Stations, Inc.; Pronto Marketing Company; Inc.; Mission Marketing Group, Inc.; Good Guys Lube N' Tune, Inc.; Challenge Marketing Co., Inc.; California Target Supply, Inc.	)	
	)	**Nos. 97-56635**
Debtor,	)	**97-56636**
	)	**97-56638**
George E. Schulman, Chapter 7 Trustee,	)	
	)	**D.C. Nos.**
	)	**CV-97-04724-DT**
Appellant-Cross-Appellee	)	**CV-97-08324-DT**
	)	**LA 96-1575 SB**
v.	)	
	)	
State of California; California State Water Resources Control Board; California Underground Storage Tank Cleanup Fund; John P. Caffre; James M. Stuchater; Mark Del Peiro; Mary Jane Forster; John W. Brown,	)	**OPINION**
Appellees-Cross-Appellants.	)	

Appeal from the United States District Court
for the Central District of California
Dickran M. Tevrizian, District Judge, Presiding

Argued and Submitted
June 8, 1999 – Pasadena, California

Filed January 12, 2001

Before: James M. Browning, Sidney R. Thomas, and
Kim McLane Wardlaw, Circuit Judges.

Opinion by Judge Wardlaw

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OPINION

WARDLAW, Circuit Judge:

In these consolidated bankruptcy appeals, the California State Water Resources Control Board (the "State Board") and the California Underground Storage Tank Cleanup Fund (the "Fund") challenge the district court's orders denying them Eleventh Amendment immunity. In particular, the State Board contends that it is an arm of the state of California, that it did not waive its Eleventh Amendment immunity, and that 11 U.S.C. § 106 does not validly abrogate such immunity. The Fund raises a narrower Eleventh Amendment question, arguing merely that it is an "arm of the state." The State Board also appeals the district court's order ruling that abstention is not appropriate, under 28 U.S.C. § 1334(c), and, on cross-appeal, George E. Schulman, the bankruptcy trustee, (the "Trustee") seeks reversal of the district court's order finding that fees payable to the Fund are "taxes" for bankruptcy purposes, under 11 U.S.C. § 507(a)(8). We affirm in part, reverse in part, dismiss in part, and remand for further proceedings.

More precisely, we hold that while the State Board is an arm of the State of California, it has waived its Eleventh Amendment immunity in the Trustee's mandamus action. In the Fund's appeal, we apply our five-factor test and hold that the Fund is an "arm of the state" and therefore entitled to invoke Eleventh Amendment immunity. Finally, we dismiss the State Board's abstention appeal and the Trustee's cross-appeal for lack of jurisdiction.

I. BACKGROUND

On July 27, 1992, upon the seizure by the State of California of the bank accounts held by Divine Grace Lazar and Gary Lazar (the "debtors" or the "Lazars") for nonpayment of gasoline taxes, including payments imposed for contribution to the Fund, the Lazars voluntarily petitioned for Chapter 11 reorganization on behalf of themselves and eight of their corporate entities.[1] The corporate cases were substantively consolidated and ordered jointly administered with the Lazars' personal bankruptcy proceedings. George Schulman was appointed as Chapter 11 trustee and, on September 14, 1994, when the cases were converted to Chapter 7, was appointed as trustee of the Chapter 7 estate.

The Lazars and their entities owned, operated and leased some 200 retail gasoline stations throughout Southern California in the 1980s and early 1990s. In May 1992, the Los Angeles County Grand Jury returned an indictment against the Lazars, their corporate entities, and certain other individuals for environmental crimes resulting from their operation of the gas stations, including illegal disposal of hazardous wastes and falsification of tank test results related to leaking gas tanks at the Lazars' mostly older gas stations. In September 1994, the Lazars pleaded *nolo contendere* to the charges of conspiracy and falsification of the underground storage tank test results, and, on February 22, 1995, the state court sentenced the Lazars to eight years in custody and fined their companies more than $400 million.

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[1] A ninth corporate case was filed approximately one year before the others, and was substantively consolidated with them.

The state criminal charges arose from violations of the Barry Keane Underground Storage Cleanup Trust Fund Act (the "Act"), enacted by the California legislature in 1989 to address the problem of leaking petroleum underground storage tanks and the threat they pose to public health and safety and the environment. *See* Cal. Health & Safety Code § 25299.10 (West 1999 & Supp.2000). The Act imposes duties on owners or operators of underground storage tanks, including the duty to investigate the condition of the tanks, to clean up leaks, and to establish evidence of financial responsibility for taking corrective action and compensating others for damage caused by the leaks. The Act established the Fund, a reimbursement program administered by the State Board that is used by small gasoline purveyors to comply with the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901 *et seq.* (1994), which requires these small gasoline purveyors to demonstrate financial ability to pay clean-up claims for damages caused by their leaking underground storage tanks.

The Fund is financed by a "fee" imposed on underground storage tank owners for each gallon of gasoline or other petroleum product stored in a permitted tank. Owners and operators of petroleum underground storage tanks may file a claim against the Fund to recover costs associated with corrective action taken in response to unauthorized releases. Cal. Health & Safety Code § 25299.54 (West 1999 & Supp.2000). Before filing for bankruptcy on July 27, 1992, California Target Enterprises, one of the Lazar companies, submitted twenty claims against the Fund to the State Board. The Trustee became the holder of the twenty claims as a result of his appointment as trustee of the bankruptcy estate.

In November 1993, the Controller of the State of

California (the "Controller") submitted proofs of claims for unpaid taxes against California Target Enterprises totaling in excess of $31 million in the bankruptcy proceedings. The California State Board of Equalization (the "BOE") submitted at least five proofs of claims for unpaid taxes totaling in excess of $13 million in the bankruptcy proceedings during the years 1993 through 1995. An unspecified portion of this over $44 million in claims is for taxes payable to the Fund.

The twenty reimbursement claims were denied on November 3, 1994, by David Deaner, a member of the State Board's staff and the Manager of the Fund ("Final Staff Decision"). The November 3 letter cited misconduct by the Lazars as the basis for denial. The Trustee filed an appeal of the Final Staff Decision, which was summarily denied by Harry Schueller, Chief of the State Board's Division of Clean Water Programs, in a letter dated March 9, 1995 ("Final Division Decision"). The Trustee then filed an Amended Petition for Board Review of Final Division Decision ("Amended Petition") and a Request for Hearing and Oral Argument ("Request for Hearing"). The Amended Petition and Request for Hearing were deemed denied by operation of law 270 days after the State Board received them. *See* Cal.Code Regs. tit. 23, § 2814.3(d) (2000).

Having exhausted his administrative remedies, the Trustee filed a Petition for Peremptory Writ of Administrative Mandamus or Other Appropriate Writ against the State Board in the Superior Court of the State of California for the County of Los Angeles on March 13, 1996 (the "Mandamus Adversary"). In the Mandamus Adversary, the Trustee sought "a writ requiring the [State] Board to reinstate the Trustee's claims against the [Fund], pay the claims in accordance with

the statutory prioritization scheme, and thereby to permit the Trustee to use the [Fund] as a mechanism for demonstrating financial responsibility for operation of underground storage tanks in accordance [with] the provisions of state and federal law." The Trustee also sought "actual damages" in excess of $2.2 million, "reasonable attorneys fees," and "such other and further relief as appears appropriate under the circumstances." On March 22, 1996, the Trustee filed a Notice of Removal of the Mandamus Adversary to the United States Bankruptcy Court for the Central District of California, pursuant to 28 U.S.C. § 1452.[2] In response, the State Board filed a Motion for Remand or in the Alternative Abstention and Remand. The State Board argued that: (1) the bankruptcy court's subject matter jurisdiction over the action was foreclosed by the Eleventh Amendment; (2) the bankruptcy court lacked subject matter jurisdiction under 28 U.S.C. § 1452(a) because the action concerned enforcement by the State of California of its

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[2]Under 28 U.S.C. § 1452(a), "[a] party may remove any claim or cause of action in a civil action ... to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title." 28 U.S.C. § 1452(a) (1994). Under 28 U.S.C. § 1334(a) and (b), the district courts "have original and exclusive jurisdiction of all cases under title 11" and "have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." *Id.* § 1334(a), (b). In other words, "[t]hose matters falling under the heading of concurrent jurisdiction (i.e., civil actions involving claims that arise under or in or are related to Title 11 proceedings) may be filed originally in state court, then subsequently removed by one of the parties to federal district court." Maitland v. Mitchell (In re Harris Pine Mills), 44 F.3d 1431, 1435 (9th Cir.1995); *see also* 16 James Wm. Moore et al., *Moore's Federal Practice* § 107.15[8][b], at 107-131 (3d ed.2000) (noting that "unlike the general removal statute, which authorizes only defendants to remove, the bankruptcy removal statute authorizes *any* party to remove").

police or regulatory powers; and (3) under 28 U.S.C. § 1334(c)(2), the bankruptcy court must abstain from hearing the action and remand it to state court, or, in the alternative, the bankruptcy court should abstain and remand in the interests of justice, comity and respect for state law, under 28 U.S.C. § 1334(c)(1).

In an opinion dated September 3, 1996, the bankruptcy court rejected each of the State Board's arguments and denied the motion. *See Schulman v. California State Water Resources Control Bd. (In re Lazar)*, 200 B.R. 358 (Bankr.C.D.Cal.1996). It found that the Mandamus Adversary was not a civil action by a governmental unit to enforce that unit's police or regulatory power and was therefore properly removed under 28 U.S.C. § 1452(a). It also concluded that the requirements for mandatory abstention were not met, principally because the Mandamus Adversary did not present a purely state law question, and because it is a core proceeding within the meaning of 28 U.S.C. § 1334(c)(2). The bankruptcy court rejected the State Board's permissive abstention arguments, finding that the factors set forth in *Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.)*, 912 F.2d 1162, 1167 (9th Cir.1990), weighed against abstention. For similar reasons, the court found that remand was not warranted by any equitable consideration. Leaving the constitutional issues for last, the bankruptcy court, while suggesting but not holding that a state's waiver of sovereign immunity under 11 U.S.C. § 106(b) was invalid after *Seminole Tribe v. Florida*, 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996), ruled that the State of California waived its sovereign immunity by filing its proofs of claims in the bankruptcy proceeding and "by making a general appearance in support of its position as one of the most substantial secured creditors in case." *Schulman*, 200 B.R. at 377. The State

Board timely appealed to the Bankruptcy Appellate Panel.

Meanwhile, on June 14, 1996, the Trustee had filed "a complaint to determine and subordinate the [BOE's] postpetition claim[s]," to "recover damages for unlawful misconduct of agencies of the State of California[,] and to recover payments improperly paid" against the State of California, the State Board, and the Fund (the "Tax Adversary").[3] In this action, the Trustee moved for partial summary judgment for determination of two discrete issues: (1) whether the Fund is an arm of the state capable of invoking immunity under the Eleventh Amendment;[4] and (2) whether the monies paid into the Fund are properly characterized as "fees" and not "taxes." The bankruptcy court denied the motion in a Order dated June 6, 1997, ruling that the Fund is an entity of the State of California for the purpose of claiming sovereign immunity under the Eleventh Amendment and that the fees imposed as payment to the Fund are taxes for the purposes of 11 U.S.C. § 507(a)(8).[5] The Trustee timely appealed to the

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[3]Also named as defendants to the Tax Adversary were the California State Board of Equalization, the California Franchise Tax Board, eleven individuals in their official capacities as members of agencies of the State of California and one person in his individual capacity.

[4]Because the Fund was not a party to the Mandamus Adversary, it was not covered by the bankruptcy court's prior ruling that the state had waived its immunity.

[5]11 U.S.C. § 507(a) "sets forth nine categories of claims that are entitled to priority in bankruptcy cases." 4 Collier on Bankruptcy § 507.01, at 507-9 (15th ed. rev.2000). Under 11 U.S.C § 507(a)(8), "[a]n eighth priority is granted ... to allowed unsecured claims of a governmental unit for certain kinds of prepetition taxes." *Id.* § 507.10 [1], at 507-54.

United States District Court for the Central District of California, and successfully moved to consolidate the Mandamus and Tax Adversaries.

The district court affirmed the bankruptcy court's order denying the State Board's Motion for Remand or Abstention, but reversed in part and affirmed in part the bankruptcy court's order denying the Trustee's Motion for Partial Summary Judgment. The district court held that: (1) the fees paid into the Fund are taxes for purposes of 11 U.S.C. § 507(a)(8), notwithstanding any contrary characterization by California state law; (2) the Fund is not an arm of the state capable of invoking the Eleventh Amendment;[6] and (3) the bankruptcy court correctly decided against abstention in the Mandamus Adversary. The parties' cross-appeals of this decision are before us.

II. MANDAMUS ADVERSARY

A. Eleventh Amendment Immunity

We must first address whether the State Board enjoys Eleventh Amendment immunity in the Mandamus Adversary.

We have jurisdiction to review the district court's denial of the State Board's claim of Eleventh Amendment immunity under the collateral order doctrine. *Puerto Rico Aqueduct &*

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[6]Once it held that the Fund, which it determined would be the source of any money damages, was not an "arm of the state," the district court found that the State Board's Eleventh Amendment immunity claim was moot.

Sewer Auth. v. Metcalf & Eddy, Inc. 506 U.S. 139, 147, 113 S.Ct. 684, 121 L.Ed.2d 605 (1993). We review questions of Eleventh Amendment immunity de novo. *Hill v. Blind Indus. & Servs.*, 179 F.3d 754, 756 (9th Cir.1999), *amended by* 201 F.3d 1186 (9th Cir.2000). "Under the law of this circuit, an entity invoking Eleventh Amendment immunity bears the burden of asserting and proving those matters necessary to establish its defense." *Id.* at 1186.

The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

U.S. Const. amend. XI. "Although the text of the Amendment would appear to restrict only the Article III diversity jurisdiction of the federal courts," *Seminole Tribe v. Florida*, 517 U.S. 44, 54, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996), the Eleventh Amendment "stand[s] not so much for what it says, but for the presupposition ... which it confirms." *Kimel v. Florida Bd. of Regents*, 528 U.S. 62, 120 S.Ct. 631, 640, 145 L.Ed.2d 522 (2000) (quoting *Seminole Tribe*, 517 U.S. at 54, 116 S.Ct. 1114 (quoting *Blatchford v. Native Village of Noatak*, 501 U.S. 775, 779, 111 S.Ct. 2578, 115 L.Ed.2d 686 (1991))) (internal quotation marks omitted). "That presupposition ... has two parts: first, that each State is a sovereign entity in our federal system; and second, that ' "it is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent." ' " *Seminole Tribe*, 517 U.S. at 54, 116 S.Ct. 1114 (quoting *Hans v. Louisiana*, 134 U.S. 1, 13, 10

S.Ct. 504, 33 L.Ed. 842 (1890) (quoting *The Federalist* No. 81, at 487 (Alexander Hamilton) (Clinton Rossiter ed., 1961))). Indeed, as the Supreme Court has recently explained, "the sovereign immunity of the States neither derives from nor is limited by the terms of the Eleventh Amendment." *Alden v. Maine*, 527 U.S. 706, 119 S.Ct. 2240, 2246, 144 L.Ed.2d 636 (1999). Rather, "sovereign immunity derives ... from the structure of the original Constitution itself." *Id.* at 2254.[7] Although some may wish to factually dispute whether "a longstanding tradition [exists] in the bankruptcy courts, dating back to 1979, of allowing the bankruptcy courts to enforce applicable law against the states," *see Schulman v. California State Water Res. Control Bd. (In re Lazar)*, 200 B.R. 358, 376 (Bankr.C.D.Cal.1996), the Supreme Court in *Seminole Tribe* interpreted the Eleventh Amendment to apply in bankruptcy proceedings.[8] As the Court stated, "[t]he Eleventh Amendment restricts the judicial power under Article III, and Article I cannot be used to circumvent the constitutional limitations

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[7]In accordance with its historical, structural view of state sovereign immunity, the Supreme Court has stated that the phrase "Eleventh Amendment immunity" "is convenient shorthand but something of a misnomer." *Alden*, 119 S.Ct. at 2246. Like the Supreme Court, *see Kimel*, 528 U.S. 62, 120 S.Ct. 631, 145 L.Ed.2d 522, we will continue to use this "convenient shorthand."

[8]Justice Rehnquist, in responding to Justice Stevens's concern with the majority decision's possible impact in bankruptcy cases, wrote "contrary to the implication of Justice Steven's [dissent], it has not been widely thought that ... bankruptcy ... statutes abrogated the States' sovereign immunity.... Although the ... bankruptcy laws have existed practically since our Nation's inception, ... there is no established tradition in the lower federal courts of allowing enforcement of those statutes against the States." *Seminole Tribe*, 517 U.S. at 73, n. 16, 116 S.Ct. 1114.

placed upon federal jurisdiction." *Seminole Tribe*, 517 U.S. at 72-73, 116 S.Ct. 1114.

The district court held that Eleventh Amendment immunity did not apply in the Mandamus Adversary because the Fund, which it determined would be the source of any money damages, was not an "arm of the state." The State Board is the only named defendant in the Mandamus Adversary, however, and "with respect to the ... Eleventh Amendment question, it is the entity's potential legal liability, rather than its ability or inability to require a third party to reimburse it, or to discharge the liability in the first instance, that is relevant." *Regents of Univ. of Cal. v. Doe*, 519 U.S. 425, 431, 117 S.Ct. 900, 137 L.Ed.2d 55 (1997). Therefore, to determine whether Eleventh Amendment immunity applies here, we must assess the nature of the State Board, a task made easy by the California legislature.

The California Water Code provides that the State Board "shall exercise the adjudicatory and regulatory functions of the state in the field of water resources," *Cal. Water Code* § 174 (West 1971), and that the State Board "is in the California Environmental Protection Agency" and "consist[s] of five members appointed by the Governor," *id.* § 175. Thus, the State Board correctly contends that it is an agency of the State of California, and the Trustee does not dispute this contention. *See Rounds v. Oregon State Bd. of Educ.*, 166 F.3d 1032, 1035 (9th Cir.1999) ("To determine whether [an entity] enjoys Eleventh Amendment immunity, we must look to its nature as created by state law.") (citing *Regents of Univ. of Cal. v. Doe*, 519 U.S. at 429-30 & n. 5); *cf. Dittman v. California*, 191 F.3d 1020, 1026 (9th Cir.1999) (holding that the State of California Acupuncture Committee is a state agency entitled to Eleventh

Amendment immunity), *cert. denied,* --- U.S. ----, 120 S.Ct. 2717, 147 L.Ed.2d 982 (2000). "[U]nder the eleventh amendment, agencies of the state are immune from private damage actions or suits for injunctive relief brought in federal court." Id. at 1025 (quoting *Mitchell v. Los Angeles Community College Dist.*, 861 F.2d 198, 201 (9th Cir.1988)) (internal quotation marks omitted); *see also Pennhurst State Sch. & Hosp. v. Halderman*, 465 U.S. 89, 100, 104 S.Ct. 900, 79 L.Ed.2d 67 (1984) ("It is clear, of course, that in the absence of consent a suit in which the State or one of its agencies or departments is named as the defendant is proscribed by the Eleventh Amendment.").

The State Board's Eleventh Amendment immunity is not absolute, however. "[A] State may waive its sovereign immunity by consenting to suit." *College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 119 S.Ct. 2219, 2223, 144 L.Ed.2d 605 (1999) (citing *Clark v. Barnard*, 108 U.S. 436, 447-48, 2 S.Ct. 878, 27 L.Ed. 780 (1883)). Furthermore, "Congress may authorize such a suit in the exercise of its power to enforce the Fourteenth Amendment--an Amendment specifically designed to alter the federal-state balance." Id. (citing *Fitzpatrick v. Bitzer*, 427 U.S. 445, 96 S.Ct. 2666, 49 L.Ed.2d 614 (1976)). The Trustee argues that both of these circumstances are present in the Mandamus Adversary. Therefore, to determine whether the State Board enjoys Eleventh Amendment immunity, we must determine whether it waived that immunity or whether Congress abrogated that immunity in a valid exercise of its

constitutional powers.[9]

1. Waiver

"[A] State's sovereign immunity is 'a personal privilege which it may waive at pleasure.' " Id. at 2226 (quoting *Clark*, 108 U.S. at 447, 2 S.Ct. 878). "Generally, we will find a waiver either if the State voluntarily invokes our jurisdiction or else if the State makes a 'clear declaration' that it intends to submit itself to our jurisdiction." *Id.* (citations omitted).

The Trustee argues that the State Board waived its Eleventh Amendment immunity in the Mandamus Adversary because other agencies of the State of California, namely the BOE and the Controller, filed proofs of claims in the Lazars' bankruptcy proceedings.

In *Gardner v. New Jersey*, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947), the Supreme Court addressed the impact that filing a proof of claim in a bankruptcy proceeding has on a state's assertion of Eleventh Amendment immunity. *Id.* at 573-74, 67 S.Ct. 467. The Court held:

> It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its

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[9]Because the Trustee filed the Mandamus Adversary only against the State Board, and not against the appropriate officers of the State Board, the *Ex Parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908), exception to Eleventh Amendment immunity is, despite the Trustee's contentions to the contrary, inapposite.

> allowance must abide the consequences of that procedure. If the claimant is a State, the procedure of proof and allowance is not transmitted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State.... When the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise might have had respecting the adjudication of the claim.

Id. Last Term, the Supreme Court reaffirmed the validity of *Gardner*. *See College Sav. Bank*, 119 S.Ct. at 2228 n. 3 (stating that *Gardner* "stands for the unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts"); *see also California Franchise Tax Bd. v. Jackson (In re Jackson)*, 184 F.3d 1046, 1048-50 & n. 1 (9th Cir.1999) (relying on *Gardner* to find that the California Franchise Tax Board "waived its sovereign immunity when it filed a proof of claim for unpaid state income taxes against the Jacksons").

The question in this case, then, is not whether a state waives its Eleventh Amendment immunity by filing a proof of claim in bankruptcy. *Gardner* establishes that it does. *Gardner*, 329 U.S. at 573-74, 67 S.Ct. 467. Rather, the relevant questions are the extent of this waiver and, more concretely, how this waiver applies to the State Board in the Mandamus Adversary. We now turn to these questions.

a. The Rule of Gardner

As the Fifth Circuit has recognized, "[t]he extent to which filing a proof of claim constitutes waiver of [Eleventh Amendment] immunity is uncertain." *Texas ex rel. Board of Regents of the Univ. of Tex. Sys. v. Walker*, 142 F.3d 813, 820 (5th Cir.1998), *cert. denied,* 525 U.S. 1102, 119 S.Ct. 865, 142 L.Ed.2d 768 (1999).

> Surely, as held in the *Gardner* decision, it encompasses defenses to the claim asserted. But does it extend to the assertion of a counterclaim, and if so, must the counterclaim arise out of the same transaction or occurrence as the state's claim? If any counterclaim is permitted on this theory, is recovery limited to an offset of some or all of the state's recoverable claim, or is an affirmative recovery permitted?

Richard H. Fallon et al., *Hart and Wechsler's The Federal Courts and the Federal System* 111-12 (4th ed. Supp.1999) [hereinafter Hart & Wechsler (Supp.1999)]. Although we have never directly addressed these questions, we have applied *Gardner* in the past, and these past applications provide us with some guidance.

First, in *Confederated Tribes v. White (In re White)*, 139 F.3d 1268 (9th Cir.1998), we held, in accordance with *Gardner*, that by participating in a bankruptcy proceeding, an Indian tribal government "waived sovereign immunity respecting the adjudication of its claim against [the debtor]'s assets." Id. at 1270. In so holding, we upheld the district court's order affirming discharge of the tribal government's claim under Chapter 7 of the Bankruptcy Code. *See id.* at 1268. Similarly, in *California Franchise Tax Board v. Jackson (In re*

Jackson), 184 F.3d 1046 (9th Cir.1999), we determined that because a state agency filed a proof of claim, it was not immune from the bankruptcy court's discharge of that claim. *Id.* at 1048-50. These two decisions clarified the rule of *Gardner*: that when a state files a proof of claim against a debtor, it waives its Eleventh Amendment immunity with respect to the adjudication of that particular claim. Or, as the *Gardner* Court stated, by filing a proof of claim in bankruptcy, the state waives its immunity from "[t]he whole process of proof, allowance, and distribution" of the claim. *Gardner*, 329 U.S. at 574, 67 S.Ct. 467.

In *Jackson*, however, we indicated that this waiver may encompass more than the mere adjudication of the state's claim. We noted favorably the Fourth Circuit's holding that "when a state files a proof of claim in a bankruptcy proceeding, the state waives its sovereign immunity in regard to the debtor's claims which arise out of the same transaction or occurrence as the state's proof of claim." *Jackson*, 184 F.3d at 1049 (citing *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140, 1148 (4th Cir.1997)). This language in *Jackson* is not inconsistent with *Gardner*. Although the waiver found constitutional in Gardner was limited to the state's own claim, and thus narrower than the same-transaction-or-occurrence standard, *Gardner*, 329 U.S. at 573-74, 67 S.Ct. 467; *see also Confederated Tribes*, 139 F.3d at 1271 ("The Supreme Court made clear in *Gardner v. New Jersey* that when a sovereign files a claim against a debtor in bankruptcy, the sovereign waives immunity with respect to the adjudication of the claim." (citation omitted)); *Seay v. Tennessee Student Assistance Corp. (In re Seay)*, 244 B.R. 112, 118 (Bankr.E.D.Tenn.2000) (noting that "the operative language of *Gardner v. New Jersey* ... cannot really be read to say any more than that the filing of a

proof of claim by a state waives its sovereign immunity as to matters connected with the claims allowance process"), nothing in *Gardner* precludes a broader waiver rule, *see* Hart & Wechsler (Supp.1999), *supra,* at 111-12 (suggesting that when a state voluntarily invokes federal jurisdiction, the permissible extent of the state's Eleventh Amendment waiver goes beyond the bounds of *Gardner*); Teresa K. Goebel, Comment, *Obtaining Jurisdiction over States in Bankruptcy Proceedings after Seminole Tribe*, 65 U. Chi. L.Rev. 911 (1998) ("The *Gardner* Court held that the defensive counterclaim rule was constitutional, but did not foreclose the possibility that a broader test may be constitutional."); *cf. Danning v. United States*, 259 F.2d 305, 309-11 (9th Cir.1958) (citing *Gardner* while allowing a bankruptcy trustee to assert counterclaims against the United States up to the amount of the federal government's claim).

Our sister circuits, in addressing this question, have not yet achieved consensus on the proper rule. As noted above, the Fourth Circuit has articulated a same-transaction-or-occurrence test. *Schlossberg*, 119 F.3d at 1148 (holding that "to the extent a defendant's assertions in a state- instituted federal action, including those made with regard to a state-filed proof of claim in a bankruptcy action, amount to a compulsory counterclaim, a state has waived any Eleventh Amendment immunity against that counterclaim in order to avail itself of the federal forum"). The Tenth Circuit also has held that sovereign immunity is waived for claims arising out of the same transaction or occurrence. *Wyoming Dep't of Transp. v. Straight (In re Straight)*, 143 F.3d 1387, 1390 (10th Cir.) (indicating, without reaching the question, that the permissible extent of a state's waiver may be even broader than the same-transaction-or-occurrence test), *cert. denied,* 525 U.S. 982, 119 S.Ct. 446, 142

L.Ed.2d 400 (1998); *cf.* Fed.R.Civ.P. 13(c) (stating that a counterclaim "may claim relief exceeding in amount or different in kind from that sought in the pleading of the opposing party").[10] The Seventh Circuit, however, has indicated that when a state files a proof of claim in bankruptcy, the state's "waiver of immunity is limited to matters ... arising out of the same transaction or occurrence which is the subject matter of the suit, to the extent of defeating the [state]'s claim." *Jones v. Yorke (In re Friendship Med. Ctr., Ltd.)*, 710 F.2d 1297, 1301 (7th Cir.1983); *Dekalb County Div. of Family & Children Servs. v. Platter (In re Platter)*, 140 F.3d 676, 679 (7th Cir.1998) (stating "that no sovereign immunity problem existed where the state filed the claim and no one sought money from the state").

Consistent with this authority, we hold today that when a state or an "arm of the state" files a proof of claim in a bankruptcy proceeding, the state waives its Eleventh Amendment immunity with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence as the state's claim. However, whether these claims are limited to only compulsory counterclaim/recoupment, as the Seventh

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[10]The Eighth and Eleventh Circuits, although addressing this issue, have not explicitly decided whether *Gardner* can be extended to include claims arising out of the same transaction or occurrence. *See Rose v. U.S. Dep't of Educ. (In re Rose)*, 187 F.3d 926, 930 (8th Cir.1999) (finding that a Missouri state agency's "submission of proofs of claims in Roses' bankruptcy case waived its immunity in related proceedings required to adjudicate the dischargeability of those claims"); *Georgia Dep't of Revenue v. Burke (In re Burke)*, 146 F.3d 1313, 1319 (11th Cir.1998) (holding that "by filing a proof of claim in the debtors' respective bankruptcy proceedings, the State waived its sovereign immunity for the purposes of the adjudication of those claims").

Circuit holds, or allow for a broader affirmative recovery from the state, need not be addressed here. Because the estate's claims are slightly over $4 million and the BOE's proof of claim is at least $13 million[11] in taxes payable to the Fund, affirmative recovery beyond the proof of claim amount is not being sought in this case, and we leave for a future day the question of whether *Gardner* would so permit. We must nevertheless ascertain whether the Trustee's Mandamus Adversary arises out of the same transaction or occurrence as the BOE's proof of claim.

b. Same Transaction or Occurrence

To determine whether the Trustee's claims against the State Board in the Mandamus Adversary arise out of the same transaction or occurrence as the proofs of claims filed in the Lazars' bankruptcy case by the BOE, "we apply the so-called 'logical relationship' test of Fed.R.Civ.P. 13(a)." *Pinkstaff v. United States (In re Pinkstaff)*, 974 F.2d 113, 115 (9th Cir.1992).

A logical relationship exists when the

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[11]The Controller also filed proofs of claims in this case, totaling in excess of $31 million. Under California law, however, only the BOE has authority to file claims for underground-storage-tank (UST) fees. *See* Cal. Health & Safety Code § 25299.42 (West 1999); Cal. Rev. & Tax.Code §§ 50106, 50108 (West 1994). Therefore, because it is statutorily impossible for the Controller to have filed any authorized claims for UST fees, we find that the Controller's proofs of claims are not logically related to the Trustee's claims in the Mandamus Adversary for UST reimbursement and damages.

> counterclaim arises from the same aggregate set of operative facts as the initial claim, in that the same operative facts serve as the basis of both claims or the aggregate core of facts upon which the claim rests activates additional legal rights otherwise dormant in the defendant.

Id.; *see also Moore v. New York Cotton Exch.*, 270 U.S. 593, 610, 46 S.Ct. 367, 70 L.Ed. 750 (1926) (" 'Transaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship."); *Pochiro v. Prudential Ins. Co. of Am.*, 827 F.2d 1246, 1252 (9th Cir.1987) (noting the same).

In these proceedings, the BOE filed several proofs of claims against the Lazars' bankruptcy estate, totaling approximately $13 million. An unspecified portion of the BOE's claims are for underground-storage-tank (UST) fees.[12] In the Mandamus Adversary, the Trustee has sued the State Board to reinstate its claims for reimbursement from the Fund and for damages. Accordingly, to determine whether the State Board is entitled to Eleventh Amendment immunity in the

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[12]For the period after the Lazars voluntarily petitioned for bankruptcy, the bankruptcy court has determined that the correct amount of the BOE's claim for UST fees is $336,470.32, even though the BOE had initially asserted a $1.8 million claim. This judgment has not been appealed. There is insufficient information in the record to determine what amounts, if any, of the BOE's other proofs of claims are attributable to UST fees, and what amounts, if any, are attributable to sales and use taxes, local taxes, and fuel taxes. We hold that the BOE's non-UST-fee claims are not logically related to the Trustee's claims in the Mandamus Adversary.

Mandamus Adversary, we must determine whether the BOE's claims for unpaid UST fees are logically related to the Trustee's claims for UST reimbursement.[13] *See Pinkstaff*, 974 F.2d at 115.

The State Board argues that although an owner or operator of an underground storage tank for which a permit is required must pay fees to the Fund in sums based on the amount of petroleum that is stored in the tanks, *see* Cal. Health & Safety Code § 25299.41 (West 1999), whether an owner or operator will receive reimbursements for cleaning up petroleum leaks is dependent upon a detailed statutory scheme under which claimants receive priority based on various factors, *see id.* §§ 25299.52-25299.58 (West 1999 & Supp.2000). The State Board further asserts that, in this case, the denial of the Trustee's reimbursement claims was not based upon the nonpayment of fees, and that, therefore, the bankruptcy court could resolve the Mandamus Adversary without probing into the Lazars' payment of UST fees. Thus, the State Board contends that although the BOE's proofs of claims and the Trustee's claims in the Mandamus Adversary both revolve around the Fund and the Lazars' maintenance of underground storage tanks, the resolution of these claims involves wholly separate inquiries. We disagree.

The BOE's proofs of claims for unpaid UST fees and the Trustee's claims in the Mandamus Adversary both concern the Fund and both arise out of activities associated with the

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[13]Because under California law only the BOE may bring a claim to collect unpaid UST fees, *see supra* note 11, in assessing this question of waiver, we do not find it significant that the BOE and the State Board are separate state agencies.

same bankruptcy case. While the BOE demands payments of fees to the Fund, the Trustee seeks reimbursement from the Fund for corrective actions taken on underground storage tanks. *See Straight*, 143 F.3d at 1392 (holding that "the proofs of claim filed by the State and the motion filed by Mrs. Straight arose out of the same transaction or occurrence--the Debtor's business"); *995 Fifth Ave. Assocs. v. New York State Dep't of Taxation & Fin. (In re 995 Fifth Ave. Assocs.)*, 963 F.2d 503, 509 (2d Cir.1992) ("Thus, the appellee's claim for a tax refund arose from the same transaction or occurrence--the sale of the Stanhope Hotel--as the State's claim for additional taxes."). Moreover, the Fund collects fees from owners and operators of underground storage tanks for the ultimate purpose of paying reimbursement claims when those tanks leak petroleum. *See* Cal. Health & Safety Code §§ 25299.10, 25299.50-25299.51 (West 1999 & Supp.2000). Therefore, we hold that the Trustee's claims against the State Board in the Mandamus Adversary are logically related to the proofs of claims filed by the BOE for unpaid UST fees. *See Pinkstaff*, 974 F.2d at 115; *see also Price v. United States (In re Price)*, 42 F.3d 1068, 1073 (7th Cir.1994) ("The pertinent inquiry is whether the claim arises out of the same transaction or occurrence and not whether the claims are from the same transaction or occurrence."); *Albright v. Gates*, 362 F.2d 928, 929 (9th Cir.1966) ("In deciding what is a transaction, we take note that the term gets an increasingly liberal construction.").

Accordingly, because the BOE filed proofs of claim in the bankruptcy proceeding that arise out of the same transaction or occurrence as the Trustee's claims against the State Board in the Mandamus Adversary, the State Board has waived its

Eleventh Amendment immunity in the Mandamus Adversary.[14]

2. Abrogation

In 11 U.S.C. § 106(b), Congress provided that when a state files a proof of claim in a bankruptcy case, the state "is deemed to have waived sovereign immunity with respect to a claim against such [state] that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such [state] arose." 11 U.S.C. § 106(b) (1994). Several courts have considered the issue of whether, by enacting §§ 106(a) and (b), Congress has abrogated the States' sovereign immunity. Some courts have found that §§ 106(a) and (b) are unconstitutional because the sections were enacted pursuant to Article I of the United States Constitution. *See e.g., Sacred Heart Hosp. v. Pennsylvania, Dep't of Pub. Welfare (In*

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[14]The bankruptcy court also held, and the Trustee argues, that the State Board waived its Eleventh Amendment immunity in the Mandamus Adversary because the State of California made a "general appearance" in the underlying bankruptcy case in support of its position as one of the most substantial secured creditors in this case. This argument fails, to the extent it is distinct from the argument, analyzed above, that the State Board waived its Eleventh Amendment immunity under *Gardner*. Here, unlike other factual circumstances in which courts have been more receptive to this argument, the State Board immediately asserted an Eleventh Amendment defense in the Mandamus Adversary and moved for remand to state court. *Cf. Wisconsin Dep't of Corrections v. Schacht*, 524 U.S. 381, 393, 118 S.Ct. 2047, 141 L.Ed.2d 364 (1998) (Kennedy, J., concurring) ("Consent to removal, it can be argued, is a waiver of the Eleventh Amendment immunity."); *Hill*, 179 F.3d at 763 ("The Eleventh Amendment was never intended to allow a state to appear in federal court and actively litigate the case on the merits, and only later belatedly assert its immunity from suit in order to avoid an adverse result.").

re Sacred Heart Hosp.), 133 F.3d 237, 243-44 (3d Cir.1998) (holding 11 U.S.C. § 106(a), which purports to abrogate sovereign immunity, unconstitutional); *Department of Transp. & Dev. v. PNL Asset Management Co. (In re Estate of Fernandez)*, 123 F.3d 241, 245 (5th Cir.) (same), *amended by* 130 F.3d 1138 (5th Cir.1997) (per curiam); *In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d at 1147-48 (holding section 106(b) unconstitutional). Other courts have concluded that §§ 106(a) and (b) are constitutional because the Bankruptcy Code was enacted pursuant to Section 5 of the Fourteenth Amendment-which has long been recognized by the Supreme Court as a valid source of congressional power to abrogate state's Eleventh Amendment immunity.[15] *See e.g., In re Straight*, 209 B.R. 540, 555 (D.Wyo.1997) (concluding that application of the Fourteenth Amendment to Section 106 renders it constitutional), *aff'd*, 143 F.3d 1387 (10th Cir.), *cert. denied*, 525 U.S. 982, 119 S.Ct. 446, 142 L.Ed.2d 400 (1998); *In re: Headrick*, 200 B.R. 963, 967 (Bankr.D.Ga.1996) ("the Fourteenth Amendment allows debtors to enforce the provisions of the Bankruptcy Code in federal court notwithstanding the States' Eleventh Amendment immunity.").

Because we have determined that the state waived its Eleventh Amendment immunity rendering permissible the estate's counterclaim against the state, we refrain from reaching

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[15]In the Supreme Court case, *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996), the Court held that Congress may not abrogate state's Eleventh Amendment immunity from suit in federal court pursuant to its powers under Article I. *Id.* at 72-73, 116 S.Ct. 1114. However, the *Seminole Tribe* Court still recognized Section 5 of the Fourteenth Amendment as a valid source of congressional power to abrogate states' Eleventh Amendment immunity. *Id.* at 59, 116 S.Ct. 1114.

the question of the constitutionality of sections 106(a) or (b). *State of Maryland v. E.P.A.*, 530 F.2d 215, 227 (4th Cir.1975) ("[I]f a case can be decided on either of two grounds one involving a constitutional question, and the other, a question of statutory construction or general law, the court should decide on the basis of the latter."), *vacated on other grounds,* 431 U.S. 99, 97 S.Ct. 1635, 52 L.Ed.2d 166 (1977); *see e.g., Rose*, 187 F.3d at 930 (concluding that because the court found that the state had "waived its Eleventh Amendment immunity, [the court] need not reach issues of the constitutionality of the abrogation provision of § 106(a) and the statutory provision of § 106(b)").

3. Conclusion

In sum, we hold that because the BOE filed proofs of claims in the Lazars' bankruptcy case that are logically related to the Trustee's claims against the State Board in the Mandamus Adversary, the State Board has waived its Eleventh Amendment immunity in the Mandamus Adversary.

B. Abstention

The State Board also argues that the bankruptcy court erred by not abstaining in the Mandamus Adversary, pursuant to 28 U.S.C. §§ 1334(c)(1) and 1334(c)(2).[16] In *Security Farms*

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[16]Because the Lazars filed their bankruptcy petition prior to October 22, 1994, the amendments made to § 1334 by the Bankruptcy Reform Act of 1994 do not apply in this case. *See* Wynns v. Wilson (In re Wilson), 90 F.3d 347, 350 (9th Cir.1996) (noting that "the Bankruptcy Reform Act of 1994 applies only in bankruptcy cases filed on or after

v. International Brotherhood of Teamsters, 124 F.3d 999 (9th Cir.1997), however, we noted that "[a]bstention can exist only where there is a parallel proceeding in state court." *Id.* at 1009. Thus, we held that:

> Section 1334(c) abstention should be read in pari materia with section 1452(b) remand, so that [§ 1334(c)] applies only in those cases in which there is a related proceeding that either permits abstention in the interest of comity, section 1334(c)(1), or that, by legislative mandate, requires it, section 1334(c)(2).

Id. at 1010. On March 22, 1996, the Trustee successfully removed the Mandamus Adversary from state court, and, as a result, "[n]o other related [state] proceeding thereafter exists." Id. Accordingly, because there is no pending state proceeding, §§ 1334(c)(1) and 1334(c)(2) are simply inapplicable to this case. *See id.* at 1009-10.[17]

October 22, 1994").

[17]In *Eastport Associates v. City of Los Angeles (In re Eastport Associates)*, 935 F.2d 1071 (9th Cir.1991), we reviewed the district court's order refraining from abstention under § 1334(c)(1), even though "no state court proceeding ha[d] been commenced in [the] case." *Id.* at 1079. The Mandamus Adversary is distinguishable from *Eastport Associates*, however, because the action in *Eastport Associates* was not removed to federal court. *See id.* at 1078-79. Thus, the remand provisions of 28 U.S.C. § 1452(b) were inapplicable in *Eastport Associates*. *See* 28 U.S.C. § 1452(b). In this case, on the other hand, as in *Security Farms*, we are confronted with the interrelationship between § 1334(c) and § 1452(b). *See Security Farms*, 124 F.3d at 1010 ("To require a pendant state action as a condition of abstention eliminates any confusion with 28 U.S.C. §

Furthermore, to the extent that the State Board appeals the bankruptcy court's decision against remanding the Mandamus Adversary, and "to the extent that we are required to construe [the State Board's] motion to abstain as a motion to remand," *id.* at 1009, we lack jurisdiction over the appeal. 28 U.S.C. § 1452(b) (1994) (stating that "a decision to not remand ... is not reviewable by appeal or otherwise by the court of appeals"); *Security Farms*, 124 F.3d at 1009-10 & n. 7 ("Section 1452(b) prevents this court from reviewing a district court's decision not to remand.").

III. TAX ADVERSARY

In the Tax Adversary, we are confronted with two distinct issues. The Fund appeals the district court's determination that it is not an "arm of the state" and thus cannot invoke Eleventh Amendment immunity. The Trustee cross-appeals the district court's order affirming the bankruptcy court's judgment that the fees paid into the Fund are "taxes" for the purposes of bankruptcy, pursuant to 11 U.S.C. § 507(a)(8). We examine each issue in turn.

A. Arm of the State

We have jurisdiction under the collateral order doctrine to review the district court's denial of the Fund's claim that it is an arm of the State of California. *Metcalf & Eddy, Inc.*, 506 U.S. at 147, 113 S.Ct. 684. We review questions of Eleventh Amendment immunity de novo. *Hill*, 179 F.3d at 756.

1452(b)....").

In determining the Eleventh Amendment status of a defendant, "[t]here may be a question ... whether a particular suit in fact is a suit against a State." *Pennhurst*, 465 U.S. at 100, 104 S.Ct. 900. It is well established that the Eleventh Amendment's "reference to actions 'against one of the United States' encompasses not only actions in which a State is actually named as the defendant, but also certain actions against state agents and state instrumentalities." *Regents of the Univ. of Cal. v. Doe*, 519 U.S. at 429, 117 S.Ct. 900.

We inquire into the relationship between the state and its instrumentality to decide whether it may invoke the state's immunity. *Id.* In particular,

> [t]o determine whether a governmental agency is an arm of the state, the following factors must be examined: [1] whether a money judgment would be satisfied out of state funds, [2] whether the entity performs central governmental functions, [3] whether the entity may sue or be sued, [4] whether the entity has the power to take property in its own name or only the name of the state, and [5] the corporate status of the entity.

Durning v. Citibank, N.A., 950 F.2d 1419, 1423 (9th Cir.1991) (quoting *Mitchell v. Los Angeles Community College Dist.*, 861 F.2d 198, 201 (9th Cir.1988)) (internal quotation marks omitted). "[W]hether a particular state agency ... is an arm of the State ... is a question of federal law. But that federal question can be answered only after considering the provisions of state law that define the agency's character." *Regents of the Univ. of Cal. v. Doe*, 519 U.S. at 429 n. 5, 117 S.Ct. 900. On

balance, we hold that the five *Durning* factors compel the conclusion the Fund is an arm of the State of California.

The first factor, namely "whether a judgment against the [Fund] under the terms of the [Tax Adversary] complaint would have to be satisfied out of the limited resources of the [Fund] itself or whether the state treasury would also be legally pledged to satisfy the obligation," *ITSI TV Prods., Inc. v. Agricultural Ass'ns*, 3 F.3d 1289, 1292 (9th Cir.1993) (quoting *Durning*, 950 F.2d at 1424) (internal quotation marks omitted), provides little guidance in this case. That is, in the Tax Adversary, the Trustee seeks from the Fund both reimbursement for the "improper payment of fees" and actual damages, and these differing claims point us in different analytical directions.

More precisely, under California law, the Trustee's reimbursement claims would be "paid only out of the [F]und," Cal. Health & Safety Code § 25299.60(b) (West 1999), and "the [California] state treasury is not liable," *Durning*, 950 F.2d at 1425; *see* Cal. Health & Safety Code § 25299.60. Thus, to the extent the Trustee seeks reimbursement from the Fund in the Tax Adversary, this first factor weighs against an arm-of-the-state finding. *See Durning*, 950 F.2d at 1424-26 ("When a state entity is structured so that its obligations are its own special obligations and not general obligations of the state, that fact weighs against a finding of sovereign immunity under the arm of the state doctrine."). As to the Trustee's non-reimbursement, damages claims, however, no statute specifically protects the state treasury from a court judgment against the Fund, and, in fact, California law provides that when the Fund sunsets, all of its liabilities shall be transferred to the state's general fund. Cal. Gov't Code § 16346 (West

1995) (providing that whenever a special fund in the state treasury is abolished, and no successor fund is specified in the act providing for abolition, all of the special fund's liabilities shall be transferred to and become a part of the general fund). Thus, to the extent the Trustee seeks not reimbursement, but actual damages from the Fund in the Tax Adversary, this factor appears to weigh in favor of an arm-of-the-state finding. In short, this first factor "is a close question and for this reason is entitled to little weight in the overall balance." *Belanger v. Madera Unified Sch. Dist.*, 963 F.2d 248, 254 (9th Cir.1992).

The second factor in our arm-of-the-state inquiry, however, is not uncertain, and it weighs strongly in favor of finding that the Fund is an arm of the state. The Fund "performs central governmental functions," *Rounds*, 166 F.3d at 1035, and "California exercises substantial centralized control over the [Fund]," *Belanger*, 963 F.2d at 253; *see also Franceschi v. Schwartz*, 57 F.3d 828, 831 (9th Cir.1995) (noting that, in performing an arm- of-the-state analysis, a court must "assess the extent to which the entity 'derives its power from the State and is ultimately regulated by the State.' " (quoting *Greater Los Angeles Council on Deafness, Inc. v. Zolin*, 812 F.2d 1103, 1110 (9th Cir.1987)).

The California legislature created the Fund to protect "public health and safety and the environment" in light of the perception that "a significant number of the underground storage tanks containing petroleum in the state may be leaking." Cal. Health & Safety Code § 25299.10(b)(1), (3) (West 1999 & Supp.2000). Nonetheless, the Trustee argues that the Fund was enacted primarily for the financial benefit of tank owners. In particular, he characterizes the Fund as an insurance measure sponsored by a service-station lobby and as

a means by which underground storage tank owners and operators may comply with their federal financial-responsibility requirements.

That the Fund works to the benefit of owners and operators of underground storage tanks does not diminish its public importance. Rather, the language of the authorizing statute demonstrates that the Fund performs services that benefit owners and operators for the purpose of protecting the public health. *Id.* § 25299.10(b)(5), (6) (West 1999 & Supp.2000) ("There are long- term threats to public health and water quality if a comprehensive, uniform, and efficient corrective action program is not established.... It is in the best interest of the health and safety of the people of the state to establish a fund to pay for corrective action where coverage is not available.").

Moreover, the California Health and Safety Code is replete with provisions establishing that the state is both the Fund's source of power and its ultimate regulator. For example, section 25299.50(a) provides that the Fund is created in the state treasury. *See id.* § 25299.50(a). This same section authorizes the State Board to expend the Fund's monies "upon appropriation by the Legislature." *Id.* Therefore, we conclude that the Fund "derives its power from the State." *Franceschi*, 57 F.3d at 831.

We also conclude that the Fund is ultimately regulated by the state through the State Board. By statute, the State Board must "report at least once every three months on the [payment of claims from the Fund] to the Senate Committee on Budget and Fiscal Review, the Senate Committee on Environmental Quality, the Assembly Committee on Budget,

and the Assembly Committee on Environmental Safety and Toxic Materials, or to any successor committee, and to the Director of Finance." Cal. Health & Safety Code § 25299.50(c)(2) (West Supp.2000). Additionally, the State Board has statutory authority to "modify existing accounts or create accounts in the [F]und or other funds administered by the board, which the board determines are appropriate or necessary for proper administration." *Id.* § 25299.50(a) (West 1999 & Supp.2000). The state's regulation of the Fund is also manifested through the BOE's statutory authority to adopt regulations to carry out its role as the collector of Fund fees. *See id.* § 25299.42(a) (West 1999).

Accordingly, we find that this second factor weighs heavily in favor of finding that the Fund is an arm of the state.

As for the remaining factors, the California legislature has not granted the Fund corporate status or given it the power to take property in its own name. Thus, these two factors weigh in the Fund's favor. *See Durning*, 950 F.2d at 1427. Finally, the Fund admits that it may sue or be sued in its own name, which would weigh against an arm-of-the-state finding. *See id.* at 1427. Although recent legislation adds some uncertainty to this admission, *compare* Cal. Health & Safety Code § 25299.52(g) (West 1999) ("The fund may sue and be sued in its own name."), *with id.* § 25299.52 (West.Supp.2000) (deleting subsection (g), pursuant to 1999 legislative amendments), this factor does not turn the balance in any event.

For the foregoing reasons, then, we must conclude that, on balance, the Fund is an arm of the State of California,

thereby entitled to invoke Eleventh Amendment immunity.[18] In reaching this conclusion, we find it most significant that the California legislature established the Fund to serve the central governmental function of ensuring safe and healthy water resources for the state's citizens.

B. Fees as Taxes

The Trustee has cross-appealed in the Tax Adversary, arguing that the district court erred in finding that the fees paid into the Fund are taxes under 11 U.S.C. § 507(a)(8). Because we lack jurisdiction over this non-final judgment, however, we cannot consider the Trustee's appeal.

Under 28 U.S.C. § 158(d), we "have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under" 28 U.S.C. § 158(a). 28 U.S.C. § 158(d) (1994). 28 U.S.C. § 158(a) in turn provides that "[a] district court has jurisdiction over a bankruptcy appeal from: (1) final judgments, orders, or decrees, and (2) interlocutory orders with leave from the bankruptcy court." *Duckor Spradling & Metzger v. Baum Trust (In re F.R.T.C., Inc.)*, 177 F.3d 774, 779 (9th Cir.1999) (citing 28 U.S.C. § 158(a)(1), (3)). The Trustee "did not seek or obtain leave from the bankruptcy court to appeal. Thus, the district court had jurisdiction over the appeal, if at all, as a final judgment." *Id.*

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[18]Whether the Fund, as opposed to the State Board, waived its Eleventh Amendment immunity is not before us on this appeal. We therefore leave that question to the bankruptcy court on remand. In answering this question, the bankruptcy court may find guidance in our discussion of the State Board's waiver of immunity. *See supra* Part II.A.1.

"[T]his court has adopted a 'pragmatic approach' to finality in bankruptcy cases." Id. at 780. "This 'pragmatic approach' ... focuses on whether the decision appealed from 'effectively determined the outcome of the case.' " *Elliott v. Four Seasons Properties (In re Frontier Properties, Inc.)*, 979 F.2d 1358, 1363 (9th Cir.1992) (quoting *In re Mason*, 709 F.2d 1313, 1318 (9th Cir.1983)). Specifically, "[a] bankruptcy court order is final and thus appealable 'where it 1) resolves and seriously affects substantive rights and 2) finally determines the discrete issue to which it is addressed.' " *Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis)*, 113 F.3d 1040, 1043 (9th Cir.1997) (quoting In re Frontier Properties, Inc., 979 F.2d at 1363). "[T]raditional finality concerns nonetheless dictate that we avoid having a case make two complete trips through the appellate process." *Id.* (internal quotation marks and citations omitted).

In response to the Trustee's motion for partial summary judgment, the bankruptcy court ruled that "[t]he Fees imposed by Article 5 of Chapter 6.75 of the California Health & Safety Code are taxes for the purposes of 11 U.S.C. § 507(a)(8)." The Trustee argues that this ruling is final under § 158(a) because the court's "characterization [of the monies paid into the Fund] will determine the priority of payments ... because taxes have priority and fees do not." We reject the Trustee's argument.

It is true, of course, that the Bankruptcy Code grants priority status to "taxes." 11 U.S.C. § 507(a)(8) (1994). The Tax Adversary, however, is, at its core, an action by the Trustee

seeking equitable subordination[19] of the BOE's postpetition claims for UST fees. In *United States v. Noland*, 517 U.S. 535, 116 S.Ct. 1524, 134 L.Ed.2d 748 (1996), and *United States v. Reorganized CF & I Fabricators, Inc.*, 518 U.S. 213, 116 S.Ct. 2106, 135 L.Ed.2d 506 (1996), the Supreme Court held that "[d]ecisions about the treatment of *categories* of claims in bankruptcy proceedings ... are not dictated or illuminated by principles of equity and do not fall within the judicial power of equitable subordination." *Noland*, 517 U.S. at 541 (emphasis added) (omission in original) (quoting *Burden v. United States*, 917 F.2d 115, 122 (3d Cir.1990) (Alito, J., concurring in part and dissenting in part)) (internal quotation marks omitted); *accord Reorganized CF & I Fabricators, Inc.*, 518 U.S. at 229, 116 S.Ct. 2106 ("The principle is simply that categorical reordering of priorities that takes place at the legislative level of consideration is beyond the scope of judicial authority to order equitable subordination under § 510(c)."). In so doing, however, the Supreme Court reaffirmed what is relevant to this case: that " 'principles of equitable subordination' permit[ ] a court to make exceptions to a general rule when justified by particular facts." *Noland*, 517 U.S. at 535, 116 S.Ct. 1524; *see also Paulman v. Gateway Venture Partners III, L.P. (In re Filtercorp, Inc.)*, 163 F.3d 570, 583 (9th Cir.1998) (noting that "equitable subordination requires that ... the claimant who is to

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[19]"Equitable subordination requires that (1) the claimant who is to be subordinated has engaged in inequitable conduct; (2) the misconduct results in injury to competing claimants or an unfair advantage to the claimant to be subordinated; and (3) subordination is not inconsistent with bankruptcy law." *Paulman v. Gateway Venture Partners III, L.P. (In re Filtercorp, Inc.)*, 163 F.3d 570, 583 (9th Cir.1998) (quoting *Spacek v. Thomen (In re Universal Farming Indus.)*, 873 F.2d 1334, 1337 (9th Cir.1989)) (internal quotation marks omitted).

be subordinated has engaged in inequitable conduct"). The Trustee alleges such "particular facts" and "inequitable conduct" in his Tax Adversary complaint. Thus, if the bankruptcy court rules in favor of the Trustee on his equitable-subordination claim, the BOE's claims for UST fees, be they "taxes" or not, will be subordinated. *See Noland*, 517 U.S. at 535, 116 S.Ct. 1524.[20]

Because the bankruptcy court's order did not "resolve the question of priority," then, it is not final. *United States v. Stone (In re Stone)*, 6 F.3d 581, 583 n. 1 (9th Cir.1993); *accord Christian Life Ctr. Litig. Defense Comm. v. Silva (In re Christian Life Ctr.)*, 821 F.2d 1370, 1373 (9th Cir.1987) (holding that the bankruptcy court's order was final and appealable because it "finally determined the question of subordination of officers' indemnity claims" and "[n]o further action on this issue [wa]s contemplated or necessary"); *see also In re P.R.T.C., Inc.*, 177 F.3d at 780 (noting that, to be "final," a bankruptcy order must "finally determine[ ] the discrete issue to which it is addressed" and "resolve[ ] and seriously affect[ ] substantive rights"). The district court, therefore, did not have jurisdiction under § 158(a). 28 U.S.C. § 158(a); *In re P.R.T.C.*, Inc., 177 F.3d at 779 (explaining the district court's jurisdiction over bankruptcy appeals). And "we do not have jurisdiction to review cases in which the district court affirms an order of the bankruptcy court that is not final." *Vylene Enters., Inc. v. Naugles, Inc. (In re Vylene Enters.*, Inc.), 968 F.2d 887, 895 (9th Cir.1992). Accordingly, we dismiss the

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[20]Indeed, in his motion in the bankruptcy court for partial summary judgment on the taxes-versus-fees question, the Trustee argued only that "the [BOE's] claim for Fees ... can be *more easily equitably subordinated* as pled in the complaint because they are not taxes." (emphasis added).

Trustee's cross-appeal.[21]

IV. CONCLUSION

In the Mandamus Adversary, we hold that the State Board is an arm of the State of California, but that it has waived its Eleventh Amendment immunity. Accordingly, we affirm in part and reverse in part the district court's judgment that the State Board enjoys no Eleventh Amendment immunity in the Mandamus Adversary. We also dismiss the State Board's abstention appeal for lack of jurisdiction.

In the Tax Adversary, we hold that the Fund is an arm of the state, and we therefore reverse the district court's judgment to the contrary and remand for further proceedings. Finally, we dismiss the Trustee's cross-appeal for lack of jurisdiction.

AFFIRMED in part, REVERSED in part, DISMISSED in part, and REMANDED.

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[21]The State Appellants' motion to strike portions of the Trustee's reply brief is Granted. The Trustee's appeal in this case was limited to the two issues discussed above relating to the Tax Adversary. On February 12, 1998, we issued an order stating that the Trustee may file a reply brief for his appeal. Because portions of the Trustee's reply brief discuss issues extending beyond the subject matter of his appeal, we are compelled to order those portions stricken so as not to unfairly disadvantage the State Appellants in resolving the Trustee's appeal.

United States Bankruptcy Court,
C.D. California.

In re Gary LAZAR and Divine Grace Lazar, Debtors.
In re CALIFORNIA TARGET ENTERPRISES, INC., et al., Debtors.
George E. SCHULMAN, Chapter 7 Trustee, Plaintiff/Petitioner,
v.
CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, et al., Defendants/Respondents.

Bankruptcy Nos. LA 92-39039SB, LA 92-39042 SB.
Adv. No. LA 96-01575 SB.

Sept. 3, 1996.

David Gould, Mary Ellen Hogan, McDermott, Will & Emory, Los Angeles, CA, for debtors.

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OPINION ON MOTION FOR REMAND OR ABSTENTION

SAMUEL L. BUFFORD, Bankruptcy Judge.

I. Introduction

This adversary proceeding raises the issue of whether a chapter 7 trustee can be compelled to litigate in state court the denial of his administrative claim filed against the California Underground Storage Tank Cleanup Fund ("the Fund"), where the denial was based on the prepetition misconduct of the debtors, and the state has filed a claim for unpaid taxes to support this fund and has otherwise taken an active role in this case. The Court holds that the state's motion to remand this proceeding to state court must be denied. The police power disqualification for removal does not apply, because the removed action is not an action *by* the state, and it does not involve the exercise of its police or regulatory power. This proceeding is not subject to mandatory abstention, because it involves a core proceeding under the Bankruptcy Code, and it does not raise purely state law questions. The factors relevant to discretionary abstention weigh substantially against such abstention, and equitable grounds also weigh substantially in favor of denying the motion.

In addition, the Eleventh Amendment does not deny this Court jurisdiction to hear this proceeding, because the state has waived its sovereign immunity rights thereunder in two respects. First, it has filed claims that are logically related to this proceeding such that this proceeding arises out of the same transaction or occurrence, within the meaning of Bankruptcy Code § 106(b). Second, the state has made a general appearance in this case, which waives its right to object to this Court's exercise of jurisdiction over it based on the Eleventh Amendment.

II. Relevant Facts

A. The Underlying Bankruptcy Cases

The underlying bankruptcy cases are nine substantively consolidated cases filed by corporations under the control of Divine Grace Lazar and Gary Lazar, which are jointly administered with the personal case of the Lazars. Prior to the filing of the cases, the Lazars and their entities held interests in some 200 retail gasoline stations in Southern California, which the entities owned, operated or leased. The Lazars filed their joint case and eight of the corporate cases under chapter 11 in July, 1992, when the State of California seized the debtors' bank accounts for nonpayment of gasoline taxes, including the taxes imposed for contributions to the fund at issue in this motion. The final corporate case, which is substantively consolidated with the others, was filed approximately a year prior to the other cases.

George Schulman was appointed as chapter 11 trustee by the district court in September, 1994, during a brief period of time when the reference of the case to the bankruptcy court had been withdrawn. The corporate cases were subsequently substantively consolidated and ordered jointly administered with the Lazar individual case. A year later the cases were converted to cases under chapter 7, and Schulman was appointed as the chapter 7 trustee.

The Lazars were apparently some of the worst actors in the petroleum industry. Each is now serving an eight-year sentence for environmental crimes in connection with the

operation of the gasoline stations. In fact, they were the first ever to be prosecuted for the criminal violation of the California environmental laws.[1] In addition, each is under indictment for federal crimes arising out of the same conduct and for the underreporting of federal gasoline taxes. On the state charges, the corporations have been fined a total of $400 million. Furthermore, Texaco appeared early in this case and claimed that the debtors were selling adulterated gasoline at branded Texaco stations:[2] this controversy was resolved when the debtors gave up the Texaco brand rights.

Leaking tanks at retail gasoline stations constitute one of the most serious environmental problems in the United States. Prior to the 1990's, gasoline stations installed single-hulled tanks, which tended to rust and develop leaks as they aged. More recently, double-hulled tanks, which are much less prone to leakage, have been required. The leaking of older gas tanks has rendered virtually every gas station in the United States an environmental disaster. The Lazar's specialized in the ownership of older stations, which were economically marginal, and where the tanks were especially prone to leakage.

The environmental authorities depend on gas station owners and operators to test their own tanks for leakage and

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[1]At the invitation of the Court, the Los Angeles County prosecutor has explained that the Lazars were at the head of the list for prosecution for environmental crimes because of their falsification of gasoline tank test reports.

[2]This allegation was also aired by National Broadcasting Company in its "Dateline" news commentary.

to report the test results to the state. Tanks are tested periodically by pumping a pressurized inert gas into the tanks and waiting a period of time to see whether the pressure holds. If the pressure decreases beyond a certain level, the tanks are diagnosed as leaking tanks and must be replaced at the owner's expense. The honest reporting of the pressure tests is an essential feature of the regulation of environmental hazards at gasoline stations. The Lazars pleaded nolo contendere in a state criminal proceeding to the charge of falsifying the tank tests, and are currently serving eight-year sentences for this conduct.

B. The Fund

In 1989 the California legislature enacted the Barry Keene Underground Storage Tank Cleanup Trust Fund Act in response to the problem of leaking petroleum underground storage tanks and the threat that they posed to the public health and safety and to the environment. Cal.Health & Safety Code §§ 25299.10- 25299.81 (West 1992 & Supp.1996). This act imposes duties on owners and operators of underground storage tanks, including the duty to investigate the condition of the tanks periodically, and to clean up any leaks into the soil and ground water. Tank owners and operators are also required to establish evidence of financial responsibility for taking such corrective action and for compensating third parties for damage resulting from leaks.

The act also establishes the Fund to assist owners and operators with the costs of corrective action and the compensation of third parties. The Fund may also satisfy the

financial responsibility requirements that the law imposes on owners and operators. The Fund is financed by a storage fee imposed on the tank owners for each gallon of gasoline or other petroleum product stored in a permitted tank. The Fund is administered by the State Water Resources Control Board ("SWRCB"), which has adopted regulations implementing and interpreting the statute. *See* Cal.Code Regs., tit. 23, §§ 2610-2728 and 2803- 2814.3.

The Fund is a reimbursement program. In order to obtain reimbursement from the Fund, or to use the Fund to meet financial responsibility requirements, an owner or operator must meet certain eligibility requirements. Cal.Health & Safety Code §§ 25299.57-25299.58 (West Supp. 1996). The eligibility requirements include an obligation to demonstrate compliance with the statute, and a showing that any unauthorized release of petroleum products did not result from gross negligence, or intentional or reckless conduct by the claimant. *Id.* § 25299.57.

The California State Board of Equalization ("SBE") and the state controller have filed claims in these consolidated cases totaling more than $44 million for unpaid taxes. An unspecified portion of this amount is for taxes payable to the Fund. In addition, California has imposed tax levies against the various debtors, and has appeared frequently in the case to protect its resulting secured claim.

C. The Adversary Proceeding

In early 1992, some of the debtors filed numerous claims with the Fund, twenty of which are the subject of the

underlying administrative action. The trustee inherited these claims when he was appointed in this case. In November, 1994 the SWRCB staff issued a decision denying the claims, and the trustee's administrative appeal has been unsuccessful. The claims were denied on the grounds of misconduct by the Lazars. On March 13, 1996 the trustee filed a petition for a writ of administrative mandamus[3] in the Los Angeles County Superior Court, and on March 21 he removed it to this Court. The State of California now moves this Court to remand this adversary proceeding to the Los Angeles County Superior Court.

III. Statutory Arguments

The California SWRCB moves to remand this proceeding to the Superior Court on both statutory and constitutional grounds. The Court reserves the constitutional issue until last, on the grounds that it should not be addressed if there is an adequate non-constitutional basis for its decision.

The California SWRCB argues for remand on four separate statutory grounds. First, SWRCB contends that this adversary proceeding is not removable from state court, because it concerns the enforcement of the state's police or regulatory power. Second, SWRCB argues that this

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[3]Administrative mandamus is the procedure prescribed by the California Code of Civil Procedure for challenging a state or local government administrative action. *See* Cal.Civ.Proc.Code § 1094.5 (West Supp.1996). *See generally,* California Administrative Mandamus (2d ed. 1989 & Supp.1994).

adversary proceeding is subject to mandatory abstention, and thus must be remanded. Third, SWRCB claims that the proceeding qualifies for discretionary abstention, which should be granted in this case. Fourth, SWRCB contends that equitable considerations compel the remand of this adversary proceeding to state court. The Court finds each of these arguments unpersuasive.

A. Police Power

Removal from state court to bankruptcy court and remand back to state court is governed by 28 U.S.C.A. § 1452 (West 1994). Section 1452(a) provides:

> A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

Section 1334[4] is the general grant of bankruptcy jurisdiction to the district courts. Pursuant to 28 U.S.C.A. § 157(a),[5]

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[4]28 U.S.C.A. § 1334 (West 1993 & Supp.1996).

[5]Section 157(a) provides: Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

28 U.S.C.A. § 157(a) (West 1993).

each district is authorized to adopt a general order of reference to send all bankruptcy cases to the bankruptcy judges for the district, and in fact all districts (including this district) have so ordered. Thus the removed action from the state court came to this Court.

The SWRCB contends that this is an action to enforce its environmental laws, and thus constitutes a "civil action ... to enforce [its] police or regulatory power." In consequence, SWRCB argues, the "police or regulatory power" exception in the statute makes this adversary proceeding non-removable. The Court finds this argument unconvincing.

To invoke this exception to the removal power, the state must prevail on two points: the action must be brought (1) *by* a governmental unit, and (2) to enforce that governmental unit's police or regulatory power. The Court finds that neither requirement is met in this adversary proceeding.

1. Action by a Governmental Unit

It is manifest that neither the action in the state court nor the prior administrative application was brought by the SWRCB (or by any other governmental unit). Before these bankruptcy cases were filed, the debtor filed applications with the SWRCB for benefits under the Fund. Upon the bankruptcy filings, the debtor-applicant was succeeded by the debtor in possession, and subsequently by the trustee upon his appointment.

After the Fund denied the applications (which the

trustee was then prosecuting), the trustee filed an administrative mandamus proceeding in the Superior Court, and then removed it to this Court. The SWRCB filed no action, not even a counterclaim, in any of the proceedings. In all respects SWRCB was a respondent, not an initiator of any action. Thus this is not an action *by* the SWRCB in any sense.

The SWRCB argues that a finding that this action was not brought by a governmental unit would exalt form over substance, because in substance it involves the state's enforcement of its environmental laws. This argument proves too much. Most actions against a government involve in some manner the government's enforcement of its laws. If the Court were to adopt this argument, the requirement that the action be brought *by* a state would largely disappear. The Court is thus unpersuaded.

2. Enforcement of Police or Regulatory Power

The second factor that the state must show, to establish its claim that this action is not removable from state court, is that it involves the state's enforcement of its police or regulatory power. The state fails in this regard, also.

Outside of bankruptcy, the police and regulatory powers of government are construed very broadly. As the United States Supreme Court has stated, "the police power, in its broadest sense, includes all legislation and almost every function of civil government." *Sligh v. Kirkwood,* 237 U.S. 52, 59, 35 S.Ct. 501, 502, 59 L.Ed. 835 (1915). The Supreme Court has further stated, "[i]t is the most essential of

powers, at times the most insistent, and always one of the last limitable powers of government." *Eubank v. Richmond,* 226 U.S. 137, 142-43, 33 S.Ct. 76, 77, 57 L.Ed. 156 (1912) (citation omitted).

Where the police and regulatory powers come into conflict with the bankruptcy powers, however, they cannot be construed so broadly. This broad scope of the police power may conflict with the priority scheme that Congress has established for a liquidation bankruptcy, and may upset the timing in a reorganization case. Thus two different federal interests are in competition in a bankruptcy case, and the exercise of the constitutional bankruptcy power in the federal courts must be reconciled with the state's exercise of its police power. Where two constitutional interests come into conflict, each must be narrowed to a provide for the other.

a. Case Law Interpreting § 1452(a)

There is little case law interpreting the "police or regulatory power" language in § 1452(a). The Court has found only three such reported opinions.

The most analogous reported opinion is *Ohio ex rel. Fisher v. Forster (In re Forster),* 146 B.R. 383 (Bankr.N.D.Ohio 1992), where the bankruptcy court remanded to state court a state action to require the debtor to comply with certain environmental laws and to recover costs resulting from violations thereof. The remanding court found that this enforcement of environmental statutes and regulations constituted an exercise of regulatory power. *Id.* at 384.

However, *Forster* involved very different facts from those in this case. This case does not involve the debtor's compliance with environmental laws, the state's enforcement of such laws against an unwilling debtor, or recovering costs for violation thereof. Instead, it involves the debtor's qualification for benefits from a fund established to assist gasoline station owners in complying with environmental regulations. Furthermore, the matter comes to this Court only in an administrative mandamus action following an adverse administrative decision against the debtor. *Forster,* in contrast, was an action by the state to obtain injunctive relief and damages from the debtor. Thus *Forster* is not useful in determining whether this matter is removable to this Court.

The Court has found two other cases, quite different from this case, which apply the police or regulatory power" exception to § 1452(a). In the two cases, courts found that removal was prohibited by the police or regulatory power provision: *Departmental Disciplinary Comm. v. Shapiro (In re Friedman & Shapiro),* 185 B.R. 143 (S.D.N.Y.1995) (attorney disbarment action); *In re Rabzak,* 79 B.R. 966 (Bankr.E.D.Pa.1987) (prosecution for dumping refuse and rubbish in violation of township ordinance). The courts in both of these cases found it unnecessary to engage in any detailed analysis to arrive at their conclusions (apparently because the outcome was so obvious), and the opinions provide little help in determining the appropriate scope of the police or regulatory of government in this context.

b. Case Law Interpreting Same Language in § 362(b)(4)

There is another possible source of assistance in interpreting the "police or regulatory power" exception to removability. This same language is used in Bankruptcy Code § 362(b)(4) to describe an exception to the automatic stay of § 362(a) that results from the filing of a bankruptcy case. The "police or regulatory power" language is construed narrowly in § 362(b)(4).

First, a note of caution. Care must be used in relying on a different Bankruptcy Code provision using the same language, in light of the holding of the United States Supreme Court that the same language used even in different subsections of the same section of the Bankruptcy Code may not have the same meaning. *Dewsnup v. Timm,* 502 U.S. 410, 417-20, 112 S.Ct. 773, 778-80, 116 L.Ed.2d 903 (1992) (holding, based on pre-Code rule, that "allowed secured claim" in § 506(d) has different meaning from that in § 506(a), where contrary interpretation would mark a major change in pre-Code practice and legislative history was silent on subject).

The analysis of the scope of the police or regulatory power exception to § 362(a) begins with the legislative history of § 362(b)(4) and (5). The House Report states:

> Paragraph (4) excepts commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory power. Thus, where a governmental unit is suing a debtor to prevent or stop violation for fraud, environmental protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under

> the automatic stay. Paragraph (5) makes clear that the exception extends to permit an injunction and enforcement of an injunction, and to permit the entry of a money judgment, but does not extend to permit enforcement of a money judgment.

S.Rep. No. 989, 95th Cong., 2d Sess. 52 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5838; H.R.Rep. No. 595, 95 Cong., 1st Sess. 343 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6299.

The circuits are divided on the scope of the police or regulatory power exception, and the Ninth Circuit has not taken a position. The First and Sixth Circuits take the more narrow approach, under which the exception applies only where the government is seeking through its action to protect public health, safety, and welfare, and not seeking to protect a pecuniary interest. *Word v. Commerce Oil Co. (In re Commerce Oil Co.),* 847 F.2d 291, 295-96 (6th Cir.1988); *Corporacion de Servicios Medicos Hospitalarios v. Mora (In re Corporacion de Servicios Medicos Hospitalarios),* 805 F.2d 440, 445 n. 4 (1st Cir.1986). In contrast, the Eighth Circuit takes a slightly broader approach to the scope of the exception, and applies it where the state will not obtain a pecuniary advantage, as opposed to a protecting a pecuniary interest. *United States v. Commonwealth Cos. (In re Commonwealth Cos.),* 913 F.2d 518, 524-25 (8th Cir.1990).

The Ninth Circuit addressed the meaning of the § 362(b)(4) in *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n,* 997 F.2d 581 (9th Cir.1993), where it stated:

> [T]he terms "police or regulatory power" as used in [subsection (b)(4)] refer to the enforcement of state laws affecting health, morals, and safety but not regulatory laws that directly conflict with the control of the *res* or property by the bankruptcy court.

Id. at 591 (emphasis in original). In *Hillis* the court held that a state's dissolution of the corporate debtor for failure to satisfy state filing requirements, while the bankruptcy case was pending, was a violation of the automatic stay. Thus the state did not qualify for the § 362(b)(4) and (b)(5) exceptions. Neither the facts of the *Hillis* decision nor the Ninth Circuit's language in deciding the case provide much assistance in deciding the case before the Court. Furthermore, the *Hillis* decision does not assist in choosing between the broader or the narrower interpretation of the § 362(b)(4) exception.

The reported opinion most similar to this proceeding is *In re Psychotherapy & Counseling Center, Inc.*, 195 B.R. 522 (Bankr.D.D.C.1996), where the court found that an action to exclude a health provider from a provider payment program administered by the Department of Health and Human Services did not qualify for the § 362(b)(4) exception to the automatic stay. The court arrived at this conclusion notwithstanding its adoption of the broader "pecuniary advantage" interpretation of the exception.

c. Construction of § 1452(a)

The narrow construction of the police or regulatory power exception to the automatic stay (under either of its formulations) does not necessarily apply to § 1452, the

removal statute. The contexts are quite different, and may call for different interpretations of the two statutory provisions.

However, there are two grounds for giving these two provisions the same interpretation. If the scope of the police or regulatory power is the same in the two provisions, then an action as to which the state has a right to proceed in state court (because it is excepted from the automatic stay) would also not be subject to removal. At the same time, any action that is subject to the automatic stay would be removable to federal court, where the bankruptcy court would determine whether the action should proceed, in view of the status of the bankruptcy case. Under this construction of the law, a state court would be called upon to decide the applicability of the automatic stay to this issue only where no party exercises the option to remove a properly removable action to bankruptcy court. This would ease the burden on state courts to interpret a highly complex bankruptcy law provision for which state judges normally have little background, experience or resources.

There is a second reason for construing narrowly the § 1452 exception to removability, where the action arises from the state's exercise of its police power. One of the important policies of the Bankruptcy Code, in contrast to the former Bankruptcy Act, was to eliminate the piecemeal litigation of matters relating to a bankruptcy case in various courts, and to concentrate them in the bankruptcy court. *See, e.g., Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87 n. 40, 102 S.Ct. 2858, 2880 n. 40, 73 L.Ed.2d 598 (1982). Thus, for example, the Bankruptcy

Code eliminated the previous distinction between summary jurisdiction (which a bankruptcy judge could exercise) and plenary jurisdiction (which could only be exercised by other courts). *See generally* 1 COLLIER ON BANKRUPTCY ¶ 3.01.[1] [b][iv] (Lawrence P. King, ed. 15th ed. 1996).

This Congressional intention has been eroded to a certain extent by subsequent Supreme Court decisions, most notably *Northern Pipeline, supra* (holding that bankruptcy judges, lacking lifetime tenure under Article III of the United States constitution, may not constitutionally decide a contract action that, absent bankruptcy, would be litigated ***370** in a non-bankruptcy court); *Granfinanciera, S.A. v. Nordberg,* 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989) (holding that a defendant in a preference action under Bankruptcy Code § 547 has a right to a jury trial); and *Seminole Tribe v. Florida,* 517 U.S. 44, ----, 116 S.Ct. 1114, 1134, 134 L.Ed.2d 252 (1996) (holding that Congress lacks authority under the Indian Commerce Clause to authorize suits against states in federal court in abrogation of their Eleventh Amendment immunity). However, this Court should not contribute to this erosion of bankruptcy court jurisdiction where it is not compelled by statute or the constitution.

For the foregoing reasons the Court holds that the § 1452(a) police or regulatory power exception to the removability of actions to federal court must be read narrowly, to permit the effectuation of the bankruptcy policy of determining all issues relating to a bankruptcy case, insofar as the Constitution permits, in a single forum (the bankruptcy court). This narrow reading construes the meaning of "police power" in the § 1452(a) exception to removability the same

as its construction in the § 362(b)(4) exception to the automatic stay.

Given this narrow construction of the police or regulatory power in this context, the Court concludes that this adversary proceeding does not involve California's exercise of such power. Like *Psychotherapy, supra,* this case involves solely the right to receive benefits from a fund established with money collected from the debtor entities, and from others similarly situated, for the reimbursement of expenses arising out of the conduct of the business of the debtors in this case.

The Court finds it unnecessary in this case to choose between the two interpretations of the police or regulatory power applicable in the § 362(b)(4) context. This action does not involve the police or regulatory power of state government in either sense. Instead, it involves the eligibility to benefit from a government funding program established with taxes paid by the debtor and others similarly situated. The denial of such benefits is in both the pecuniary advantage and the pecuniary interest of the state, because it reserves more funds for other claimants against the Fund, and thereby reduces the tax burden that the state must impose to satisfy claims against the Fund.

The Court finds that the determination of the qualification for benefits from the Fund does not involve the exercise of the police power in the narrow sense required for the application of § 1452(a).

B. Mandatory Abstention

Mandatory abstention in a bankruptcy case is provided in 28 U.S.C.A. § 1334(c)(2), which states:

> Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

28 U.S.C.A. § 1334(c)(2) (West Supp.1996). Under a general order of reference pursuant to § 157(a), § 1334(c)(2) applies to a proceeding in bankruptcy court.

Mandatory abstention requires a finding of the following elements: (1) a timely motion; (2) a purely state law question; (3) a non-core proceeding that is merely a proceeding related to a bankruptcy case; (4) no basis for federal jurisdiction apart from the bankruptcy case; (5) a pending action in state court; (6) the state court action can be timely adjudicated; (7) appropriate jurisdiction exists in the state forum. *Sedlachek v. National Bank (In re Kold Kist Brands, Inc.),* 158 B.R. 175, 178 (C.D.Cal.1993). It appears that the first, fourth, fifth and seventh elements are met in this case. Further discussion is required for the second, third and sixth elements.

1. Timely Adjudication

Most mandatory abstention motions in this Court falter on the requirement that the action "can be timely adjudicated" in state court. Since time immemorial the Los Angeles County Superior Court has not had nearly enough judges to handle the caseload pending in that court. When I practiced in that court in the early 1980's, only five-year-old civil cases were going to trial, and they were being tried only because California law requires a plaintiff to bring a case to trial in that time. *See* Cal.Civ.Proc.Code § 583.310 (West Supp.1996). More recently, the Los Angeles County Superior Court has been overwhelmed with criminal drug cases, and in the last two years with the "three strikes" criminal law initiative, which mandates much longer sentences for criminals with prior convictions of more serious crimes.[6] See, e.g., L.A. Courts Staggering Under '3- Strikes' Load, L.A. Times, Dec. 11, 1995, B4; Stephanie Simon, *Civil Courts Also Feel Squeeze of '3-Strikes' Cases,* L.A. Times, Aug. 13, 1995, A1. The prospects of the appointment of enough judges in that court to handle its caseload in the foreseeable future are quite dim.

However, an administrative mandamus action does

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[6]The California Supreme Court has recently recognized greater discretion for judges in applying the three strikes law. *People v. Superior Court (Romero),* 13 Cal.4th 497, 53 Cal.Rptr.2d 789, 917 P.2d 628 (1996). However, this alone will require the review of as many as 10,000 sentences under the old standards in Los Angeles County. *See, e.g.,* Michael D. Harris, *Judges Sought more Help on Strikes Ruling,* LOS ANGELES DAILY JOURNAL, August 23, 1996, at 1. This will contribute substantially more work to the already overwhelmed Superior Court.

not stand in line for five years with other civil cases in the Los Angeles County Superior Court. It goes directly to Department 86 in downtown Los Angeles (in which I spent considerable time as an attorney), where it is resolved expeditiously, based on the administrative record. This procedure clearly qualifies as timely adjudication within the meaning of § 1334(c)(2).

2. Purely State Law Question

The principal reason that mandatory abstention falters is that this adversary proceeding does not involve a purely state law question. To be sure, the claims against the Fund were filed prior to the bankruptcy cases, and arose purely under state law. They were brought by entities that had no need of bankruptcy assistance to make their cases. Furthermore, the substitution of the debtor in possession, and then in turn the trustee, as the claimant did not change this situation.

What changed after the bankruptcy filing is that the controlling issue now appears to be whether the Bankruptcy Code gives to the trustee a status with respect to the prosecution of claims that the prepetition debtors lacked. This aspect of the dispute is unique to the bankruptcy process.

The bankruptcy estate is a different entity from the prepetition debtors. *See, e.g., In re Powell,* 187 B.R. 642, 647 (Bankr.D.Minn.1995); *In re DeLuca,* 142 B.R. 687, 691 (Bankr.D.N.J.1992); *In re Strangis,* 67 B.R. 243, 246 (Bankr.D.Minn.1986). In many respects the trustee stands in the shoes of the creditors, rather than those of the debtors.

For the purposes of this motion, the Court assumes that the prepetition debtors engaged in conduct which disqualified them from receiving benefits from the Fund, and that their applications would have been properly denied. However, the prepetition debtors may be considered strangers to the trustee, and their misconduct may not disqualify the trustee from receiving reimbursement from the Fund. This power of the trustee arises, if at all, under the Bankruptcy Code, and does not exist outside of bankruptcy. Whether the trustee enjoys such a status different from the prepetition debtors goes to the merits of the administrative mandamus action, which is not yet before the Court.

The SWRCB candidly admits that its rejection of the claims is punitive in nature. Because of the trustee's status as the representative of the creditors, who did not engage in any of the Lazars' wrongful conduct, it may be particularly inappropriate to punish the trustee and the creditors whom he represents for this conduct. The Lazars will receive no assets from these consolidated estates, except in the remote contingency that they should turn out to be solvent. The recent criminal fine of $400 million imposed on the debtor corporations renders this possibility highly remote.

If the Court's surmise is correct, the application of state law will be simple. This will not be a matter where state law issues predominate over bankruptcy law matters. The administrative proceeding will be remanded to the SWRCB for a new determination based on the findings and legal conclusions outlined here. This will not involve any difficult or unsettled state law determinations, and this decision will be based principally upon a determination of the

relevant bankruptcy law.

Because of the SWRCB's determination that the trustee is disqualified from receiving benefits under the Fund, in consequence of wrongful conduct by the Lazars before the bankruptcy cases were filed, this proceeding no longer involves purely state law issues.

3. Core Proceeding or Related Proceeding

Section 1334(c)(2) divides bankruptcy proceedings into three categories: (1) those that are "related" to a bankruptcy case, but which could have been filed in a state court absent a related bankruptcy case, (2) those "arising under" the Bankruptcy Code, and (3) those "arising in" a bankruptcy case. The second and third categories are proceedings for which there is no basis for federal jurisdiction apart from the bankruptcy case itself.[7] The second and third categories, proceedings "arising under" the Bankruptcy Code or "arising in" a bankruptcy case, are those that are designated as "core proceedings" under 28 U.S.C.A. § 157(b). *Wood v. Wood (In re Wood),* 825 F.2d 90, 97 (5th Cir.1987). Under § 1334(c)(2), a related proceeding may be subject to mandatory abstention, if the proper conditions are met.

The fact that the proceeding raises state law issues does not require a determination that the matter does not fall

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[7]A third category of case, one which could be brought in a federal court because there is an independent basis for federal jurisdiction, is unaffected by § 1334(c)(2), and is not subject to mandatory abstention.

within the core jurisdiction of the bankruptcy court. Section 157(b)(3) specifies:

> A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

28 U.S.C.A. § 157(b)(3) (West 1993).

For the reasons stated in the previous section, this is a core proceeding, because it "concern[s] the administration of the estate," within the meaning of 28 U.S.C.A. § 157(b)(2)(A). Thus the Court finds that this is a proceeding that arises under the Bankruptcy Code, within the meaning of § 1334(c)(2), and is a core proceeding.

Thus the Court holds that mandatory abstention must be denied on two grounds: first, this proceeding does not present a purely state law question; second, it is a core proceeding within the jurisdiction of the bankruptcy court.

C. Discretionary Abstention

Discretionary abstention is provided by 28 U.S.C.A. § 1334(c)(1), which states:

> Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

28 U.S.C.A. § 1334(c)(1) (West Supp.1996). This provision applies to the bankruptcy court following reference of a case thereto. This statute gives a bankruptcy court broad discretion to abstain from hearing a matter and to remand it to state court.

Under Ninth Circuit law, the Court should consider twelve factors in determining whether to exercise discretionary abstention:

> (1) The effect or lack thereof on the efficient administration of the estate if a court recommends abstention; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficulty or unsettled nature of the applicable law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court; (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334; (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case; (7) the substance rather than the form of an asserted "core" proceeding; (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court; (9) the burden of [the bankruptcy court's] docket; (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties; (11) the existence of a right to a jury trial; and (12) the presence in the proceeding of nondebtor parties.

Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.), 912 F.2d 1162, 1167 (9th Cir.1990); *accord, Eastport Associates v. Los Angeles (In re Eastport Associates),* 935

F.2d 1071, 1075 (9th Cir.1991). No single factor is dispositive, and the decision does not turn on a counting of the number of factors on each side. Rather, a court must consider each of the factors and the evidence relating thereto, and weigh its importance in the decision on discretionary remand.

We begin with the factors favoring remand to the state court. The Court finds three such factors, factors four, five and ten. First, this proceeding was commenced in state court, and it was the trustee who brought it there. He did so because he thought that he could not bring it in this Court in the first instance. The California Code of Civil Procedure authorizes an aggrieved party to challenge a state administrative action in a superior court, but there is no provision for such a challenge in a bankruptcy court. Second, there is no jurisdictional basis for this action in this Court apart from § 1334. Third, the Court has a suspicion that the trustee would rather litigate this dispute in this Court rather than in the state court, and that the removal to this Court reflects a measure of forum shopping. These factors must be given some weight in the evaluation of the propriety of discretionary abstention.

The other nine factors, however, weigh on the side of denying abstention, and rejecting the motion to remand. There is no right to a jury trial in this matter, and there are no third parties involved. The Court has already found that this matter is a matter arising under the Bankruptcy Code.

The efficient administration of the estate is a matter of some concern to the Court. This is a case that requires half a

day of the Court's time every month. Among the Court's 3691 presently pending cases,[8] it has no other case that requires such a large measure of judicial attention. So long as a matter is pending in this Court, this Court has control over the timing of its resolution. The problem with sending a matter to another court is that this Court loses control over the timing of the case, and it may be delayed for reasons totally beyond this Court's control.

This Court has prior experience with such problems. For example, in *Kipperman v. Kidder Peabody & Co. (In re Tre Scalini),* 178 B.R. 237 (Bankr.C.D.Cal.1995), this Court approved a stipulation for arbitration of a securities claim against Kidder Peabody on the assumption that the arbitration would proceed promptly. However, after two years the arbitration had not even begun. The Court thus was required to revoke the assignment of the matter to arbitration, so that it could be disposed of promptly by way of summary judgment. While the Court is aware that administrative mandamus matters are normally handled promptly in Department 86, a denial of abstention would assure that a similar problem of delay does not arise in this matter.

The burden on this Court's docket does not weigh in favor of remand. While this Court has 3691 pending cases and 478 pending adversary proceedings, its docket is totally

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[8]For those not familiar with bankruptcy practice, this adversary proceeding does not count as one of this Court's 3691 cases. While it was a case in the Superior Court, it is categorized here as an adversary proceeding in the consolidated corporate cases. In addition to its 3691 cases, this Court has 478 pending adversary proceedings relating to those cases, including five in these consolidated cases.

current. If the Court were to set for trial next Monday morning all matters on its calendar that are ready for trial, and put this matter on the bottom of the list, it would be the second matter called. This state of the calendar is typical: it is rare for this Court to have more than one trial ready at a time. In addition, the Court operates its law and motion calendar on a weekly cycle, and the Court rules from the bench in approximately 99.9% of its hearings. The only limit on the scheduling of hearings (subject to the 21-day notice requirements of the local rules) is the Court's schedule. This matter can be heard as soon as it can be calendared. Thus, hearing this administrative mandamus proceeding will not burden this Court's docket.

Furthermore, this matter is central to this bankruptcy case. The trustee asserts that this is his largest opportunity to recover assets on behalf of the creditors, and the successful resolution of this matter could easily determine whether there are any substantial assets to distribute to creditors. The state does not dispute this contention.

We arrive finally at the most important consideration with respect to discretionary abstention. As pointed out above, it appears to the Court that the SWRCB may have erred in failing to treat the trustee as a separate party from the debtors, who does not inherit their disqualification from participating in the Fund. As a preliminary matter, it appears that this issue could be the controlling issue of law.

On balance, the Court concludes that the factors weighing against abstention substantially outweigh the factors in its favor. Insofar as the motion seeks discretionary

remand, it is denied.

D. Equitable Grounds

SWRCB's final statutory argument is that the Court should remand this matter to state court on equitable grounds. The bankruptcy removal statute, § 1452(b), provides:

> The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground.

28 U.S.C.A. § 1452(b) (West 1994).

The factors that courts consider in deciding whether to remand on equitable grounds are essentially the same as those previously considered under discretionary abstention. *See, Drexel Burnham Lambert Group, Inc. v. Vigilant Insurance Co.*, 130 B.R. 405, 407 (S.D.N.Y.1991); *Republic Reader's Service, Inc. v. Magazine Service Bureau, Inc. (In re Republic Reader's Service, Inc.)*, 81 B.R. 422, 429 (Bankr.S.D.Tex.1987) (listing five factors). Thus, for the reasons stated in considering that issue, the Court finds that the equities in this case favor a denial of the remand motion.

IV. Eleventh Amendment

Having found no statutory or equitable grounds to abstain or to grant SWRCB's motion to remand, the Court must consider the constitutional issue: whether this Court is precluded by the Eleventh Amendment from exercising jurisdiction over this action. The parties apparently agree,

and the Court assumes, that the Fund is an arm of the state within the meaning of the Eleventh Amendment.

There is a substantial tradition of the exercise of bankruptcy court jurisdiction over disputes involving state governments, which has developed since the effective date of the Bankruptcy Code on October 1, 1979. *See, e.g., California Department of Health Services v. Jensen (In re Jensen),* 995 F.2d 925 (9th Cir.1993) (adversary proceeding brought by debtor against state); *Torwico Electronics, Inc. v. New Jersey (In re Torwico Electronics, Inc.),* 8 F.3d 146 (3d Cir.1993), *cert. denied,* 511 U.S. 1046, 114 S.Ct. 1576, 128 L.Ed.2d 219 (1994) (debtor action against state agency to prohibit imposition of cleanup obligations); *Wilner Wood Products Co. v. Maine,* 128 B.R. 1 (D.Me.1991) (bankruptcy court lacks power to enjoin state environmental authority from denying application for air emission license, because debtor must comply with environmental laws). However, this tradition has recently been called into question by the United States Supreme Court in *Seminole Tribe v. Florida,* 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996). Accordingly, we must examine the Supreme Court's decision to determine the appropriate application of the Eleventh Amendment in this context.

A. *Seminole Tribe*

The Eleventh Amendment to the United States Constitution has recently received a new jolt of energy in consequence of the *Seminole* decision, where the Court found that the Eleventh Amendment barred an Indian tribe from bringing an action against the State of Florida in federal court

under the Indian Gaming Regulatory Act. This act required a state to negotiate with an Indian tribe for the purpose of entering into a tribal-state compact governing the conduct of certain gambling activities on an Indian reservation, and authorized a tribe to sue a state in federal court to compel such good faith negotiation. The Supreme Court found that such a suit violated the Eleventh Amendment's grant of immunity to states from suit against them in federal court.

The Eleventh Amendment states:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

Although the text of the amendment would appear to apply only where the citizenship of the plaintiff is diverse from that of the defendant state, the Supreme Court in *Seminole* adopted the historical view that the amendment recognizes two aspects of state sovereignty: (1) each state is a sovereign entity in the federal system of the United States; and (2) "it is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent." *Id.* at ----, 116 S.Ct. at 1122. The Supreme Court held: "Even when the Constitution vests in Congress complete law-making authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against unconsenting States." *Id.* at ----, 116 S.Ct. at 1131. Because Florida had not consented to be sued in federal court on this issue, the Supreme Court found that

federal jurisdiction over the dispute was barred by the Eleventh Amendment.

In the *Seminole* decision, the Supreme Court expressly overruled its prior decision in *Pennsylvania v. Union Gas Co.*, 491 U.S. 1, 109 S.Ct. 2273, 105 L.Ed.2d 1 (1989), where it had held that a federal court may order a state to pay environmental cleanup costs pursuant to the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"). In a decision lacking a majority opinion, the Court concluded in *Union Gas* that Congress had the authority under Article I of the Constitution to abrogate the states' Eleventh Amendment immunity that would otherwise prohibit a federal court from issuing such an order.

In *Seminole* the Supreme Court held that the Eleventh Amendment prevents Congress, acting pursuant to its Article I powers, from subjecting unconsenting states to suits brought by private parties in federal court. *Id.* at ----, 116 S.Ct. at 1131. The majority took a broad view of the Eleventh Amendment, and interpreted it to impose state sovereign immunity as a limitation on the entirety of the federal judicial power under Article III. *Id.*, at ---- - ----, 116 S.Ct. at 1131-32.

Justice Stevens took specific note of the broad reach of the Court's language, and its possible impact in bankruptcy cases, in his dissent in *Seminole.* He stated:

The importance of the majority's decision to overrule the Court's holding in *Pennsylvania v. Union Gas Co.* cannot

> be overstated. The majority's opinion does not simply preclude Congress from establishing the rather curious statutory scheme under which Indian tribes may seek the aid of a federal court to secure a State's good faith negotiations over gaming regulations. Rather, it prevents Congress from providing a federal forum for a broad range of actions against States, from those sounding in copyright and patent law, to those concerning bankruptcy, environmental law, and the regulation of our vast national economy.

Id., at ____, 116 S.Ct. at 1134. In the majority opinion, Chief Justice Rehnquist responded to this criticism in a curious fashion:

> [I]t has not been widely thought that the federal antitrust, bankruptcy, or copyright statutes abrogated the States' sovereign immunity. This Court never has awarded relief against a State under any of those statutory schemes.... Although the copyright and bankruptcy laws have existed practically since our nation's inception ... there is no established tradition in the lower federal courts of allowing enforcement of those federal statutes against the States.

Id., at ---- - ----, 116 S.Ct. at 1131-32 n. 16. (Stevens, J., dissenting). As a factual matter, we have seen that Justice Rehnquist was simply wrong insofar as bankruptcy is concerned: there is a longstanding tradition in the bankruptcy courts, dating back to 1979, of allowing the bankruptcy courts to enforce applicable law against the states.

Seminole, where it is applicable, does not altogether

prevent a trustee or debtor in possession from bringing a lawsuit against a state or state agency. Bankruptcy trustees and debtors in possession may sue states and state agencies in state court (as the trustee did in this case before removing it to this Court), with no hindrance from the Eleventh Amendment. *See, e.g., Hilton v. South Carolina Railways Commission,* 502 U.S. 197, 204-05, 112 S.Ct. 560, 564-65, 116 L.Ed.2d 560 (1991); *see generally,* S. Elizabeth Gibson, *Sovereign Immunity in Bankruptcy: The Next Chapter,* 70 AM.BANKR.L.J. 195, 203-08 (1996). State courts are required to enforce applicable federal law in suits brought before them. In addition, states have generally waived sovereign immunity for most kinds of actions that a trustee may want to bring against them. Under the Bankruptcy Act, a proceeding in state court was frequently required because bankruptcy courts were limited to summary jurisdiction. *See* 1 COLLIER ON BANKRUPTCY ¶ 3.01.[1][b][4] (Lawrence P. King, ed. 15th ed. 1996). While one of the principal reforms of the Bankruptcy Code was to eliminate this balkanization of bankruptcy jurisdiction, the *Seminole* case may require a limited return to this practice, absent an appropriate waiver.

Hans v. Louisiana, 134 U.S. 1, 10 S.Ct. 504, 33 L.Ed. 842 (1890), also stands in the way of this court's assertion of jurisdiction over the SWRCB. In *Hans* the Supreme Court determined that a citizen of a state may not prosecute a suit against the citizen's own state in a federal court. The debtor argues that this Court should not follow *Hans,* on the grounds that it is outmoded law that would be overruled by the Supreme Court today. The Court finds to the contrary. The Supreme Court explicitly relied on *Hans* in the *Seminole*

decision, and reaffirmed its validity. *Seminole,* 517 U.S. at -- --, 116 S.Ct. at 1122, 1130. *Hans* clearly remains good law.

B. Trustee as Federal Official

The trustee argues that *Seminole* does not apply to him, because he is a federal agent acting on behalf of the United States Trustee and the bankruptcy court, and not a private citizen subject to the Eleventh Amendment. The Court finds this argument unpersuasive because it would prove too much.

Under this argument, no governmental unit would ever have a sovereign immunity defense to federal jurisdiction in a bankruptcy case, in any action brought by a trustee or a debtor in possession.[9] This would make § 106 largely unnecessary and surplusage, because there would be no need to waive sovereign immunity in the first instance. This is an implausible construction of the role of the trustee.

The United States Supreme Court is in accord. In *California State Board of Equalization v. Sierra Summit, Inc.,* 490 U.S. 844, 109 S.Ct. 2228, 104 L.Ed.2d 910 (1989), the Supreme Court held that a bankruptcy trustee, as representative of the estate, was not an arm of the government such that he could avoid the imposition of state sales and use taxes on the sale of assets of the estate. *Id.* at 848-50, 109 S.Ct. at 2231-34. The Court stated:

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[9]A debtor in possession in a chapter 11 case enjoys virtually all of the powers of a trustee. *See* 11 U.S.C.A. § 1107(a) (West 1994).

> The bankruptcy trustee is the representative of the estate of the debtor, not an arm of the government, and the tax on the estate is an administrative expense of the debtor, not of the Federal Government.

Id. at 849, 109 S.Ct. at 2232-33 (citations and internal quotations omitted). The Court holds that the trustee does not have status as a federal agent that exempts him from the Eleventh Amendment defense to federal jurisdiction.

C. Waiver

As the Supreme Court specified in *Seminole,* a state may not invoke sovereign immunity, if it has consented to be sued and has waived its Eleventh Amendment rights. The Court stated explicitly in footnote 14, "this Court is empowered to review a question of federal law arising from a state court decision where a State has consented to suit...." *Id.* at ---- n. 14, 116 S.Ct. at 1131 n. 14.

State consent to suit may arise by conduct of a variety of sorts. *See generally* 13 CHARLES ALAN WRIGHT, ARTHUR R. MILLER, EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3524, at 160-66 (1984 & Supp.1996). Such a waiver may arise from the filing of a claim in a bankruptcy case, or from making a general appearance in a case. Waiver may also be given in a state statute or constitutional provision. However, the scope of the waiver turns on the nature of the conduct giving rise to it.

The Supreme Court in *Seminole* explicitly reaffirmed the effectiveness of a state's waiver of sovereign immunity,

where it is properly accomplished. In the same paragraph where it first quoted the Eleventh Amendment, the Supreme Court began its analysis of the amendment by stating that the amendment's interpretation is based principally on its presupposition of sovereign immunity, which precludes an individual's suit against a state in federal court "without its consent," and precludes such a suit "against unconsenting States." *Id.* at ----, 116 S.Ct. at 1122.

The effectiveness of a waiver has been approved by the Supreme Court in a long line of cases, including *Langenkamp, supra. Seminole,* insofar as this Court can determine, does not call into question this line of authority. It only invalidates, by implication, the effectiveness of the statutory waiver under § 106(b), absent any other grounds for waiver by action of the state itself.

The Court holds that the State of California has waived its Eleventh Amendment rights in this controversy, both by filing claims in this case and by making a general appearance in support of its position as one of the most substantial secured creditors in this case.

1. Filing a Claim

The filing of a claim in a bankruptcy case constitutes a limited waiver of sovereign immunity by a state. When a state files a claim, it waives its sovereign immunity with respect to any claim against it arising from the same transaction or occurrence.

The conditions for a waiver based on the same

transaction or occurrence are specified in the Bankruptcy Code. Section 106(b)[10] states:

> A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same *transaction or occurrence* out of which the claim of such governmental unit arose.

11 U.S.C.A. § 106(b) (West Supp.1996) (emphasis added).[11]

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[10]When the case at bar was filed, the Bankruptcy Code provided:

> A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

11 U.S.C.A. § 106(a) (West 1994). Effective October 22, 1994, Congress amended § 106 in the Bankruptcy Reform Act of 1994, Pub.L. No. 103-394, 108 Stat. 4106 (1994). The new § 106(b) was essentially a recodification of the prior § 106(a), and did not change its substance.

[11]In addition, in the Bankruptcy Reform Act of 1994 Congress rewrote § 106(a) so that it explicitly waives sovereign immunity for all governmental units under sixty specified provisions of the Bankruptcy Code. *Seminole* calls into question the validity of this waiver, insofar as it applies to state governments and agencies. However, none of these enumerated provisions appears to be at issue in this adversary proceeding.

Section 106(a) also purports to waive the sovereign immunity of the federal government as to the same Bankruptcy Code provisions. Because Congress is the legislative authority with the power to grant this waiver, the waiver is effective, if it is done with sufficient specificity. *See United*

Under this provision, the filing of a proof of claim waives that government's sovereign immunity, including its rights under the Eleventh Amendment, with respect to any claim against that government arising out of the same transaction or occurrence.

a. "Transaction or Occurrence"

The "transaction or occurrence" language of § 106(b) is familiar. It is the same language used in Rule 13(a) of the Federal Rules of Civil Procedure to define the scope of a compulsory counterclaim:

> A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the *transaction or occurrence* that is the subject matter of the opposing party's claim....

Fed.R.Civ.P. 13(a) (emphasis added). The Rule 13(a) standards apply for the interpretation of § 106. *Pinkstaff v. United States (In re Pinkstaff),* 974 F.2d 113, 115 (9th Cir.1992); *United States v. Bulson (In re Bulson),* 117 B.R. 537, 541 (Bankr.9th Cir.1990), *aff'd mem.* 974 F.2d 1341 (9th Cir.1992); *WJM, Inc. v. Massachusetts Department of Public Welfare,* 840 F.2d 996, 1003 (1st Cir.1988). In *Pinkstaff* the circuit court reversed the lower court's holding that an action against the IRS for violation of the automatic stay (by filing a notice of federal income tax lien) arose out of the same

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States v. Nordic Village, Inc., 503 U.S. 30, 33-39, 112 S.Ct. 1011, 1014-17, 117 L.Ed.2d 181 (1992).

transaction or occurrence as the tax claim itself.

What constitutes the same "transaction or occurrence," within the meaning of Rule 13(a), has defied exact definition. *See generally,* 6 WRIGHT, *supra,* § 1410, at 52-65 (2d ed. 1990). The federal courts generally follow the "logical relationship" view, that a transaction or occurrence gives rise to a mandatory counterclaim if it has a logical relationship to that pleaded in a complaint. However, it is necessary to apply this standard with some care, because it could otherwise be expanded to cover all counterclaims. 6 WRIGHT, § 1410 at 65.

Courts are divided on whether the filing of a claim by one state agency constitutes a waiver of Eleventh Amendment sovereign immunity for all other state agencies. Some courts have broadly held that the filing of a claim by one such agency constitutes a waiver of such immunity rights for all state agencies. *See, e.g., Sacred Heart Hospital v. Pennsylvania (In re Sacred Heart Hospital),* 199 B.R. 129 (Bankr.E.D.Pa.1996); *Hughes-Bechtol, Inc. v. Ohio (In re Hughes-Bechtol, Inc.),* 124 B.R. 1007, 1018 (Bankr.S.D.Ohio 1991); *Solow v. Greater Orlando Aviation Authority (In re Midway Airlines, Inc.),* 175 B.R. 239, 244 (Bankr.N.D.Ill.1994). Other courts have held that the waiver resulting from filing a claim is much more narrow. *See, e.g., Rocchio & Sons, Inc. v. Rhode Island (In re Rocchio & Sons, Inc.),* 165 B.R. 86, 88 (Bankr.D.R.I.1994); *Unicare Homes, Inc. v. Four Seasons Care Centers, Inc. (In re Four Seasons Care Centers, Inc.),* 119 B.R. 681, 683-84 (Bankr.D.Minn.1990).

This Court does not agree with the broad view of the impact of the filing of a proof of claim by one state agency. The broad view fails to give sufficient weight, in the Court's view, to the "transaction or occurrence" language in § 106(b). Accordingly, the Court must determine whether the trustee's claim against the Fund in this case has a logical relationship to the claim that the State of California has filed for unpaid taxes, including the tax contributions to the Fund.

The Ninth Circuit has taken an expansive view of what constitutes a "transaction or occurrence" under Rule 13(a). However, this view is narrower than that which would find a general waiver of sovereign immunity for the entire bankruptcy case upon the filing of a claim in the case. In *Pochiro v. Prudential Insurance Co.*, 827 F.2d 1246, 1249-53 (9th Cir.1987), the court found that the claims in a lawsuit alleging various abuses by Prudential Insurance against its former insurance salesman, based on a variety of legal theories, was logically related to Prudential's prior lawsuit against him for misappropriating confidential customer information, and was a compulsory counterclaim that could not be separately litigated.[12] The court also found that the facts underlying the Prudential lawsuit were inextricably wound up with the facts of the related action. *Id.* at 1250. Furthermore, the plaintiff in the second lawsuit had admitted that the judicial resolution of Prudential's claims (in the still-pending Prudential lawsuit) would have a pervasive

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[12] *Pochiro* was based on Arizona Rule of Civil Procedure 13(a), which is identical to F.R.Civ.P. 13(a). While the Arizona interpretation of the rule would have governed, the court found the Arizona case law sparse, and applied the federal interpretation of the rule to the case.

effect on his own lawsuit, and might even eliminate his claims entirely. The court held that "transaction" is a flexible concept that may comprehend a series of occurrences if they have a logical connection. *Id.* at 1252.

The *Pochiro* case does not set the outer bounds of the "logical relationship" test under Ninth Circuit law. It serves rather as an illustration of what the Ninth Circuit considers to fall within this category, and to show how this test should be applied. Furthermore, the Court notes the impact of the application of the "logical relationship" test in the *Pochiro* case. The plaintiff was precluded from making his claims against Prudential altogether because he had failed to assert them as a counterclaim in Prudential's lawsuit. Where the issue is the waiver of sovereign immunity, different policies may apply. Where, as in this case, the question involves the exercise of federal jurisdiction under the bankruptcy powers, the test should probably be applied more loosely, to facilitate the adjustment of all obligations of a debtor in one forum.

The Court holds that, given the facts of this particular case, there is such a logical relationship. According to the state, the taxes are imposed specifically to create the Fund, so that money is available to assist underground storage tank owners in cleaning up environmental contamination resulting from tank leakage. The Fund was specifically set up so that the contributors to the Fund would be its beneficiaries. In the Court's opinion, this creates a logical relationship sufficient to qualify as the same "transaction or occurrence" within the meaning of § 106(b).

b. California's Defenses

SWRCB attempts to avoid this result with three arguments: (1) the claims were filed by different state agencies, and the resulting waiver did not extend to SWRCB; (2) the waiver was not truly voluntary, because the state was compelled to file a claim to participate in the distribution of the bankruptcy estate; and (3) § 106 as amended is still unconstitutional, in light of *Seminole*. The Court finds none of these arguments persuasive.

i. Filing by Different State Agencies

It is true that SWRCB did not file a claim in this case. However, the fact that the claims were filed by different state agencies is unavailing, so long as they arise out of the same transactions or occurrences as those giving rise to the litigation for which bankruptcy court jurisdiction is at issue.

The California SBE has the responsibility of collecting many kinds of taxes in California, including the gasoline taxes to support the Fund in this case. However, part of the claims filed by the SBE were explicitly designated as taxes owing under the Underground Storage Tank Maintenance Fee Law, which are imposed to provide the capital for SWRCB. Thus the SBE has filed a claim on behalf of the Fund, and the Fund cannot now complain that this claim was filed by a different agency.

Furthermore, the claims that the State of California has filed in this case are not *de minimis,* and they were not filed by an agency of the state that may not have had before it the whole picture of the debtors' problems with the state.

The state tax claims are huge, more than $44 million.[13] They were filed by two of the state's principal tax-collection agencies. This statutory waiver of sovereign immunity resulting from the filing of a claim in a bankruptcy case was well known to the State of California when it filed its claims in this case.

ii. Voluntariness of Filing of Claim

The SWRCB argues that the filing of a claim cannot be a voluntary waiver of sovereign immunity, because it cannot be the waiver of any right. Forcing the state to choose between waiving its constitutional rights, the state argues, or waiving its substantive claims is not a voluntary choice. The Court finds no merit in this argument. The SWRCB in this case relies on *Piombo Corp. v. Castlerock Properties (In re Castlerock Properties),* 781 F.2d 159 (9th Cir.1986), for its argument that it has not voluntarily consented to the jurisdiction of this Court in consequence of its filing of a proof of claim. In *Castlerock* the creditor had filed a state court action before the bankruptcy case was filed, based on state contract law. This action was stayed by the automatic stay, and the creditor filed a complaint for relief from the stay[14] to proceed with the state court action. The debtor filed

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[13]Apparently the only larger claim in this case is the criminal fine recently imposed on the corporate debtors of $400 million. This claim may be subordinated to the claims of other creditors, pursuant to Bankruptcy Code § 726(a)(4).

[14]Prior to 1983, relief from stay was sought by the filing of a complaint, initiating an adversary proceeding in the bankruptcy court. In 1983 the Federal Rules of Bankruptcy Procedure were amended to convert

a state law counterclaim to the relief from stay complaint. The Ninth Circuit held that the bankruptcy court lacked jurisdiction over the counterclaim, because the counterclaim was filed before the creditor filed its claim in the case. *Id.* at 162-63. The Ninth Circuit found that the subsequent filing of the claim did not retroactively confer jurisdiction on the bankruptcy court with respect to the counterclaim. *Castlerock* gives no assistance to the SWRCB in this case because the state claim in this case was filed long before this adversary proceeding commenced.

Furthermore, several years after *Castlerock* the United States Supreme Court issued its decision in *Langenkamp v. Culp,* 498 U.S. 42, 44, 111 S.Ct. 330, 331, 112 L.Ed.2d 343 (1991), which casts doubt on any restrictive reading of the consent-conferring impact of the filing of a claim in a bankruptcy case. In *Langenkamp* the Supreme Court held that creditors who have filed claims in a bankruptcy case have thereby waived the right to a jury trial in resulting counterclaims to avoid preferential transfers.[15] Relying on the fact that the creditors had filed proofs of claim, the Court held that the creditors had triggered "the process of allowance and disallowance of claims, thereby subjecting [themselves] to the bankruptcy court's equitable power." *Id.* at 44, 111 S.Ct. at 331 (internal quotations deleted).

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relief from stay proceedings to motions, rather than adversary proceedings. *See* Fed.R.Bankr.P. 4001(a).

[15]*See also Granfinanciera, S.A. v. Nordberg,* 492 U.S. 33, 58- 59, 109 S.Ct. 2782, 2799, 106 L.Ed.2d 26 (1989), where the Supreme Court held that the right to a jury trial was not waived by a party who had not filed a claim in the bankruptcy case.

Langenkamp gives a creditor a choice. One alternative is to ignore the bankruptcy case, and thereby to avoid the jurisdiction of the bankruptcy court. In fact, many creditors do not file claims and achieve this result, but probably they do so more because they think that the effort is futile. The second alternative is to file a claim, in order to participate in the fruits of the bankruptcy process, and thereby to submit to the jurisdiction of the bankruptcy court. The fact that a particular creditor finds these choices unattractive does not convert the choice into an involuntary decision: if this were so, many of the choices that people make in many different contexts of life would be "involuntary", and some people could live virtually their entire lives without making any voluntary choices at all. The Court declines to adopt such a cramped view of the voluntary character of human choices.

Case law is in accord with this view. In *995 Fifth Avenue Associates, L.P. v. New York State Department of Taxation & Finance (In re 995 Fifth Avenue Associates, L.P.)*, 963 F.2d 503, 509 (2d Cir.), *cert. denied*, 506 U.S. 947, 113 S.Ct. 395, 121 L.Ed.2d 302 (1992), the Second Circuit found that New York's filing of an administrative claim for capital gains taxes constituted a waiver of its Eleventh Amendment rights with respect to a tax refund claim arising out of the same sales transaction.

Similarly, in *WJM, Inc. v. Massachusetts Department of Public Welfare*, 840 F.2d 996, 1002-03 (1st Cir.1988), the First Circuit held that a state that chooses to enter the federal government's exclusive bankruptcy preserve by filing a claim must pay the price of a partial waiver of its sovereign

immunity. The court in *WJM* specifically found that choosing between unpalatable alternatives did not render the decision to file a claim any the less voluntary. The court stated:

> [W]e reject the supposition, implicit in [the state's] argument, that a waiver of a constitutional right lacks validity simply because it is the outcome of a "no-win" situation. A decision to forego a constitutional protection is often difficult: the Constitution safeguards important rights. While an effective waiver must be "knowing and intelligent," it may occur even when the waiving party is between a rock and a hard place.... Here, while either choice may have been unpalatable, the DPW had its eyes open when it resolved the dilemma by filing the claims.

Id. at 1004-05 (citations omitted).

Similarly, in this case the State of California had its eyes open when it filed its claims for unpaid taxes, especially those supporting the Fund from which the debtor seeks compensation for its cleanup expenses. Accordingly, the Court holds that the FTB's filing of a claim in this case constitutes a waiver of sovereign immunity, to the extent provided in § 106(b).

iii. Constitutionality of § 106

The SWRCB further argues that the Supreme Court's decision in *Seminole* has rendered unconstitutional the entire waiver of sovereign immunity in § 106. The Court finds it unnecessary to address this argument, because it finds on

other grounds that the State of California has effectively waived its sovereign immunity with respect to the proceeding before the Court.

It is important to note what *Seminole*'s interpretation of the Eleventh Amendment leaves undisturbed. Section 106 authorizes suits against all "governmental units", as defined in § 101(27).[16] This includes the federal government and its agencies, the states and state agencies, municipalities and municipal agencies,[17] and foreign governments and their agencies. Only the states and their agencies are protected by the Eleventh Amendment, and they are the only beneficiaries of *Seminole*. All other governmental units and agencies remain subject to suit pursuant to § 106. S. Elizabeth Gibson, *Sovereign Immunity in Bankruptcy: the Next Chapter*, 70 AM.BANKR.L.J. 195, 199 (1996). Thus SWRCB's argument is overbroad: *Seminole* only affects the constitutionality of actions against a state or state agency.

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[16]The Bankruptcy Code defines a "government unit" in § 101(27):

> "Governmental unit" means United States; State ... department, agency or instrumentality of the United States ... a state....

11 U.S.C.A. § 101(27) (West 1994). Therefore, this provision purports to provide for the waiver of sovereign immunity of both the federal and state government.

[17] *Monell v. Dep't of Soc. Serv.*, 436 U.S. 658, 690 n. 54, 98 S.Ct. 2018, 2035 n. 54, 56 L.Ed.2d 611 (1978). With respect to local governments, the issue is not altogether clear cut. *See generally*, WRIGHT, *supra*, § 3524, at 130-45, and cases cited therein.

2. General Appearance

It has long been the law that the making of a general appearance in a lawsuit waives all personal jurisdictional objections. *See, e.g., Hankins v. Finnel,* 964 F.2d 853, 856 (8th Cir.), *cert. denied,* 506 U.S. 1013, 113 S.Ct. 635, 121 L.Ed.2d 566 (1992). By making a general appearance a party voluntarily submits to the jurisdiction of the court. A state that makes such an appearance waives its Eleventh Amendment rights. *Hankins,* at 856.

The State of California has appeared in this case on numerous occasions to protect its secured creditor status in consequence of its tax liens. The Court finds that these numerous appearances constitute a general appearance, that generally waives any sovereign immunity claim that it may have under the Eleventh Amendment.

3. Statutory Waiver

The United States Supreme Court has made it clear that a state may waive its sovereign immunity by statute. *See, e.g., Atascadero State Hospital v. Scanlon,* 473 U.S. 234, 238 n. 1, 105 S.Ct. 3142, 3145, n. 1, 87 L.Ed.2d 171 (1985); *Hans v. Louisiana,* 134 U.S. 1, 17-18, 10 S.Ct. 504, 508, 33 L.Ed. 842 (1890); *Cohens v. Virginia,* 19 U.S. (6 Wheat.) 264, 380, 5 L.Ed. 257 (1821). Such a waiver must be unequivocal. *Atascadero,* 473 U.S. at 239-40, 105 S.Ct. at 3146; *Welch v. Texas Department of Highways & Public*

Transportation, 483 U.S. 468, 473, 107 S.Ct. 2941, 2945-46, 97 L.Ed.2d 389 (1987).

Statutory waiver does not apply in this case. Even though a state may have waived its sovereign immunity to permit a claim against it in state court, this is not enough to waive its Eleventh Amendment immunity. *Port Authority Trans-Hudson Corp. v. Feeney,* 495 U.S. 299, 306, 110 S.Ct. 1868, 1873, 109 L.Ed.2d 264 (1990); *Atascadero,* 473 U.S. at 241, 105 S.Ct. at 3146-47. A state's interest in immunity includes not merely whether it may be sued, but also where it may be sued. *Id.; Pennhurst State School & Hospital v. Halderman,* 465 U.S. 89, 99, 104 S.Ct. 900, 907, 79 L.Ed.2d 67 (1984). For a state statute or constitutional provision to constitute a waiver of Eleventh Amendment immunity, it must specify the state's intention to subject itself to suit in federal court. *Atascadero,* at 241, 105 S.Ct. at 3146-47. California has not met this standard in this case.

D. Other Grounds for Federal Jurisdiction

In *Seminole* the United States Supreme Court notes two other possible grounds for federal jurisdiction, that are consistent with the Eleventh Amendment. These grounds are the Fourteenth Amendment, adopted nearly a century after the Eleventh Amendment, and the *Ex parte Young* doctrine.

1. Fourteenth Amendment

Nearly a century after the adoption of the Eleventh Amendment, the Fourteenth Amendment was adopted to

expand federal power at the expense of state autonomy. *Seminole,* at ----, 116 S.Ct. at 1125. This amendment fundamentally altered the balance of state and federal power struck by the Constitution, including that embodied in the Eleventh Amendment. *Id.,* citing *Fitzpatrick v. Bitzer,* 427 U.S. 445, 452-56, 96 S.Ct. 2666, 2669-71, 49 L.Ed.2d 614 (1976).

Section 1 of the Fourteenth Amendment contains prohibitions expressly directed at the states, and § 5 of that amendment expressly gives Congress the power to enforce the amendment with appropriate legislation. *Seminole,* 517 U.S. at ----, 116 S.Ct. at 1125. Thus, Congress has the power under the Fourteenth Amendment to waive sovereign immunity that is otherwise protected by the Eleventh Amendment. *Id.; Atascadero State Hospital v. Scanlon,* 473 U.S. 234, 238, 105 S.Ct. 3142, 3145-46, 87 L.Ed.2d 171 (1985). To exercise this power, Congress must make unmistakably clear in the statute that it is invoking this power under the Fourteenth Amendment to abrogate the sovereign immunity rights of states under the Eleventh Amendment. *Dellmuth v. Muth,* 491 U.S. 223, 227-28, 109 S.Ct. 2397, 2399- 400, 105 L.Ed.2d 181 (1989).

However, neither party before the Court contends that the Fourteenth Amendment provides the grounds for this Court's jurisdiction in this matter, and the Court perceives no such ground on its own.

2. *Ex Parte Young*

The *Ex parte Young* doctrine, on the other hand, is more promising for the trustee. In *Ex parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908), the United States Supreme Court held that there was federal jurisdiction over a suit against a state official, where the state itself could not be sued in federal court, when the suit sought only prospective injunctive relief in order to end a continuing violation of federal law. In *Seminole* the Supreme Court reaffirmed the continuing vitality of this rule. *Seminole*, at ----, 116 S.Ct. at 1132. However, the Court found an exception to the rule in *Seminole*, because the statute in that case contained detailed provisions on how a dispute with the state should be resolved. The Court held:

> [W]here Congress has prescribed a detailed remedial scheme for the enforcement against a State of a statutorily created right, a court should hesitate before casting aside those limitations and permitting an action against a state officer based upon *Ex parte Young*.

Id. at ----, 116 S.Ct. at 1132. Because of the detailed remedial provisions in the Indian Gaming Regulatory Act in case a state failed to negotiate in good faith, the Supreme Court found that the *Ex parte Young* doctrine was not available for a federal court to compel state officials to comply with the Act.

The case before this Court, in contrast, is quite different from the statute involved in *Seminole*. The statute involved in this case, the Bankruptcy Code, does not contain specific enforcement provision against a state, in case the state does not comply with particular obligations under the

Bankruptcy Code. There are very few provisions in the Bankruptcy Code that relate only to state authorities, and none involved in the matter before the Court.

The Supreme Court itself recognized in *Seminole* that this would be the usual situation in the bankruptcy context. In responding to Justice Stevens' criticism that *Seminole* will upset established federal jurisdiction over subjects such as bankruptcy, Justice Rehnquist further stated:

> That conclusion is exaggerated both in its substance and in its significance. First, Justice STEVENS' statement is misleadingly overbroad. We have already seen that several avenues remain open for ensuring state compliance with federal law. See *supra,* at n. 13. Most notably, an individual may obtain injunctive relief under *Ex parte Young* in order to remedy a state officer's ongoing violation of federal law.

Id. at ---- n. 16, 116 S.Ct. at 1131 n. 16. In footnote 14 Justice Rehnquist further stated for the Court, "an individual can bring suit against a state officer in order to ensure that the officer's conduct is in compliance with federal law [citing *Ex parte Young*]...." *Id.* at ----, 116 S.Ct. at 1131 n. 14.

The principal effect of the *Seminole* decision, in the bankruptcy context, may be to convert litigation against a state, such as the action against the Fund in this case, into litigation against the applicable state officers. A large number of state officials could suddenly find themselves as defendants in a very large number of lawsuits. Such a development would give new meaning to the phrase "public

servant". States should think long and hard about whether they want to precipitate *Ex parte Young* litigation against their officials, including a number at relatively low levels, before they invoke the Eleventh Amendment sovereign immunity in bankruptcy cases.

While the trustee has not invoked *Ex parte Young* in this case, it appears that this could provide a possible basis for this Court's jurisdiction (after suitable amendment of the pleadings), absent any other viable ground for bankruptcy court jurisdiction.

If it were necessary for the trustee to invoke *Ex parte Young* and bring this action against a state official, this Court would hold up any decision to abstain or to remand to state court until the trustee had an opportunity to address this procedural problem. However, the Court sees no need to invoke *Ex parte Young,* because it finds other adequate grounds for bankruptcy court jurisdiction in this matter.

V. CONCLUSION

The Court concludes that the state's motion to remand this proceeding to state court must be denied. The police power disqualification for removal does not apply, because the removed action is not an action *by* the state, and it does not involve the exercise of its police or regulatory power. This proceeding is not subject to mandatory abstention, because it involves a core proceeding under the Bankruptcy Code, and it does not raise purely state law questions. The factors relevant to discretionary abstention weigh substantially against such abstention, and equitable grounds

also weigh substantially in favor of denying the motion.

Finally, the Eleventh Amendment does not deny this Court jurisdiction to hear this proceeding, because the state has waived its sovereign immunity rights thereunder in two respects. First, it has filed claims that are logically related to this proceeding such that this arises out of the same transaction or occurrence, within the meaning of § 106(b). Second, the state has made a general appearance in this case, which waives its right to object to personal jurisdiction over it based on the Eleventh Amendment.

The Court sets a further hearing on this proceeding on September 19, 1996 at 3:00 p.m. At that time it will schedule argument on the merits of the administrative mandamus proceeding.

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

IN RE

GARY LAZAR AND DIVINE GRACE LAZAR,

Debtors,

IN RE

CALIFORNIA TARGET ENTERPRISES, INC., ET AL.,

Debtors,

CALIF. STATE WATER RESOURCES CONTROL BOARD, a board within Calif. Environmental Protection Agency, an agency of the State of California

Appellant,

vs.

CASE NO. CV 96-8324 DT

CONSOLIDATED WITH

CASE NO. CV 97-4724 DT

(BANKRUPTCY COURT CASE NUMBER LA 92-39039 SB; JOINTLY ADMINISTERED WITH LA 92-39042 SB

APPEAL FROM: ADV. NO. LA 96-01575 SB CONSOLIDATED WITH ADV. NO. LA 96-02281 SB

ORDER **AFFIRMING** THE BANKRUPTCY COURT'S ORDER DENYING DEFENDANT'S MOTION FOR ABSTENTION OR REMAND TO STATE COURT

[CV 96-8324]

GEORGE E. SCHULMAN, CHAPTER 7 TRUSTEE,

Appellee

I. Background

A. Factual Background

The underlying bankruptcy cases are nine substantively consolidated cases filed by corporations under the control of Divine Grace Lazar and Gary Lazar, administered along with the Lazar's personal bankruptcy cases. The Lazars and their entities held interests in about 200 retail gasoline stations. George E. Schulman (the "Trustee") was appointed as the Chapter 11 Trustee in 1994, and the next year the cases were converted to Chapter 7 cases. Mr. Schulman was then appointed as Chapter 7 Trustee. The Lazars are currently serving prison sentences for environmental crimes in connection with operation of the gasoline stations. The tanks at those stations appeared to be older and prone to leakage, a major environmental hazard. The California Underground Storage Tank Cleanup Fund (the "Fund"), which is administered by the State Water Resources Control Board ("SWRCB"), assists gas station owners with the costs of corrective action for such environmental hazards.

B. Procedural Posture

On July 9, 1997, this Court issued an Order

consolidating the appeals in CV 97-4724 DT, an appeal from Adversary No. LA 96-02281 (the "Tax Adversary"), and CV 96-8324 DT, an appeal from Adversary No. LA 96-01575 ("Mandamus Adversary"). The Tax Adversary was originally commenced by the Trustee against the SWRCB and other defendants seeking subordination of claims, damages, and recovery of allegedly improper payments. The Tax Adversary incorporated the Mandamus Adversary, which was an earlier Petition for Administrative Mandamus or Other Alternative Writ that the Trustee had filed to resolve a dispute regarding the SWRCB's decision to deny twenty claims brought upon the Fund by the debtors.

In the Tax Adversary, the Trustee appeals the June 6, 1997 order of the bankruptcy court denying his Motion for Summary Judgment.[1] The issues on which the Trustee sought Summary Judgment are: (1) are fees paid into the Fund by service station owners "taxes" for bankruptcy purposes?; (2) is the Fund an arm of the State of California that is entitled to assert Eleventh Amendment sovereign immunity? In the Mandamus Adversary, the SWRCB appeals the November 27, 1996 Order of the bankruptcy court denying remand of the administrative mandamus proceedings to state court. The issues on appeal in the Mandamus Adversary are: (1) may a state court proceeding appealing the SWRCB's denial of Fund

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[1]The Court notes that Appellees object to Trustee Schulman's violation of Local Bankruptcy Rule 155(2). The Trustee's Opening Brief, at 35 pages, exceeds the 30 page limit prescribed by that Rule. The Court also notes that the Trustee's Supplemental Reply Brief was filed without leave of this Court in violation of Bankruptcy Rule 8009(a)(3). The Court declines to rule on issues presented in the Trustee's Opening Brief that are raised for the first time in this appeal.

claims properly be removed to the bankruptcy court; (2) assuming the Fund is entitled to sovereign immunity under the Eleventh Amendment, has the Fund waived that immunity in this case?

II. Discussion

A. Standard of Review

Decisions of the bankruptcy court may be appealed to the district court pursuant to 28 U.S.C. § 158(a). On appeal, this Court employs a de novo standard of review with respect to issues of law decided by the bankruptcy court. In re Kashani, 190 B.R. 875, 881 (9th Cir. B.A.P. 1995).

B. Fees Paid into the Fund Are Taxes for Purposes of 11 U.S.C. § 507(a)(8).

Characterization of a financial charge or assessment as a "tax" for bankruptcy priority purposes is not dependent upon labels used under State law. In re Camilli, 94 F.3d 1330, 1331 (9th Cir. 1996). Instead, the Ninth Circuit has prescribed a four-part test for qualification of a charge as a tax. In order to constitute a tax, the charge must be (1) an involuntary pecuniary burden; (2) imposed by the state legislature; (3) for a public purpose; (4) under the police or taxing power. Id., citing In re Lorber Indus., 675 F.2d 1062, 1066 (9th Cir. 1982).

The Trustee contends that the bankruptcy court erred when it rules that fees payable to the Fund do not constitute "taxes" within the contemplation of 11 U.S.C. § 507(a)(8). In support of this contention, the Trustee relies heavily on Sinclair Paint Co. v. State Board of Equalization, 15 Cal. 4th 866, 64

Cal. Rptr. 2d 447 (1997), as well as the designation of the fees as "not taxes" in Cal. Health & S.C. § 25299.40. These California authorities, although not irrelevant, do not do away with the need for this Court to apply the Lorber standard in the present case. See Camilli, 94 F.3d at 1331. After applying Lorber to the fees in the present case, it becomes readily apparent that the fees constitute taxes for purposes of § 507, notwithstanding any contrary designation under state law.

The first prong of Lorber looks to whether the debt at issue is "an involuntary pecuniary burden." Lorber, 675 F.2d at 1066. In the present case, it is clear that fees paid to the Fund are involuntary. All permitted owners of underground storage tanks must pay their fees to the State Board of Equalization pursuant to Cal. Health & S.C. § 25299.41; tank owners have no choice in the matter. This differs from the charge at issue in the Lorber case, where a waste water discharger was forced to pay assessments based on the volume of waste discharged into the sewer. Lorber, 675 F.2d at 1064. The difference between Lorber and the present case is that the debtor in Lorber had alternatives; if the debtor had chosen not to discharge waste water into the sewer, the debtor would not have been liable for the assessment. In contrast, owners of storage tanks have no choice whether to pay fees to the Fund. Hence, the mandatory nature of § 25299.41 clearly meets the first prong of Lorber.

The second prong of Lorber requires that the debt involved must be imposed by the state legislature. Lorber, 675 F.2d at 1066. In the present case, fees paid to the Fund under § 25299.41 are undoubtedly imposed by legislative action.

The third prong of Lorber deals with the existence of a

public purpose for levying the charge. Lorber, 675 P.2d at 1066. In the present case, the fees are used to carry out the State's goal of cleaning up leaking petroleum tanks in order to safeguard the public health and welfare. The public purpose of such an enactment is readily apparent, and compares favorably to such enactments as the mining reclamation charges under 30 U.S.C. § 1201 et seq., held to be "taxes" under § 17 of the Bankruptcy Act in United States v. River Coal Co., 748 F.2d 1103, 1106 (6th Cir. 1984). Accordingly, this Court finds that the fees meet the third prong of Lorber. Also, in light of the fact that the legislative scheme authorizing the fees was passed in pursuit of a legitimate public purpose, the Court finds that the fees meet the fourth prong of Lorber, which looks to whether or not the charge is incurred pursuant to an exercise of the police or taxing power of the state. Lorber, 675 F.2d at 1066.

The Trustee argues that Cal. Health & S.C. § 25299.40 expressly characterizes fees payable to the Fund as not being taxes. However, as previously stated, the labeling of the fees as "not taxes" by the California legislature does not affect the nature of this Court's inquiry under Lorber. See Camilli, 94 F.3d at 1331. Hence, this Court **affirms** the finding of the bankruptcy court in Adversary No. LA 96-02281 that fees payable to the Fund under § 25299.41 constitute taxes for purposes of 11 U.S.C. § 507 (a)(8).

C. The Fund Is Not Entitled To Claim Immunity under the Eleventh Amendment.

In its denial of the Trustee's Motion for Summary Judgment in the Tax Adversary, the bankruptcy court did not state its reasons for finding that as a matter of law, the Fund is

entitled to Eleventh Amendment immunity. The Trustee contends that the nature of the Fund precludes treatment of the Fund as arm of the state for Eleventh Amendment purposes.

The SWRCB asserts in its Opening Brief that the Fund must be treated as an arm of the State under Mitchell v. Los Angeles Community College Dist., 861 F.2d 198 (9th Cir. 1988), cert. denied, 490 U.S. 1081 (1989). In Mitchell, the Ninth Circuit identified five factors that must be used in determining whether an entity is an arm of the state for Eleventh Amendment purposes: (1) whether a money judgment against the entity would be paid out of state funds; (2) whether the entity performs central government functions; (3) whether the entity may sue or be sued; (4) whether the entity has the power to take property in its own name or the name of the state; (5) the corporate status of the entity. Mitchell, 861 F.2d at 201. The Fund contends that it so clearly meets the first two Mitchell factors that it is entitled to Eleventh Amendment immunity.

The first Mitchell factor deals with whether a money judgment against the entity at issue would be paid out of state funds. The SWRCB contends that the designation of the Fund by Cal. Health & S.C. § 25299.50 as a part of the State Treasury favors the Fund's passing the first prong of Mitchell. However, 25299.50 is only one part of the legislative scheme creating the Fund. The Court finds that the scheme used to create the Fund prevents the Fund's assertion of Eleventh Amendment immunity.

It appears to this Court that the Fund is a self-supporting, self-maintaining entity, rather than a true creature of the State treasury. The contents of the Fund are

largely the fees paid by gas station owners. See Trustee's Excerpts of Record at 1088. Monies deposited in the Fund can only be expended for the limited purposes authorized by Cal. Health & S.C. § 25299.51, including the costs of cleaning up underground tank leakage and administrative costs. The Fund does not receive mandatory appropriations; "the State's commitment to pay claims [placed on the Fund] is contingent upon the availability of monies in the Fund." Trustee's Excerpt of Record at 1124.

As the SWRCB points out in its Opening Brief, depletion of monies in the Fund will result in the Fund having inadequate resources to pay claims, since the legislature is not required to transfer money into the Fund to cover a shortfall. See Cal. Govt. C. § 16351. Hence, the Fund itself, and not the State, bears ultimate liability for claims against the Fund. Bearing in mind that the "vulnerability of the State's purse" is one of the most significant factors in Eleventh Amendment determinations, Hess v. Port Auth. Trans-Hudson, 115 S. Ct. 394, 404 (1994), it appears to this Court that the Fund's failure to meet the first Mitchell prong is fatal to its claim of Eleventh Amendment immunity under these circumstances. The insulation of the State treasury's General fund from liability for claims against the Fund obviates the necessity for Eleventh Amendment immunity for the Fund. Accordingly, this Court reverses the finding of the bankruptcy court in Adversary No. LA 96-02281 that the Fund is entitled to claim immunity under the Eleventh Amendment.

Because this Court finds as a matter of law that the Fund is not entitled to immunity under the Eleventh Amendment, the issue of immunity waiver raised in the SWRCB appeal from the Mandamus Adversary, No. LA

96-01575 is moot.

D. Remand of the Mandamus Adversary Is Not Required.

1. Mandatory Abstention Under 28 U.S.C. § 1334(c)(2) Is Not Required.

Under 28 U.S.C. § 1334(c) (2), a bankruptcy court must abstain from hearing a proceeding "based upon a state law claim or a state law cause of action, related to a case under Title 11 but not arising under Title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section . . . if an action is commenced, and can be timely adjudicated, in a state forum of appropriate jurisdiction." This mandatory abstention provision is not applicable in the present case.

The present case implicates substantial issues of bankruptcy law. The SWRCB asserts that the Trustee cannot pursue claims against the Fund because its claims were formerly held by the Lazars; the Trustee contests this assertion. Resolution of this dispute is a substantial issue of federal bankruptcy law, for the bankruptcy court must determine whether the actions of the pre-petition debtors will be imputed to the Trustee. Therefore, notwithstanding SWRCB's dismissal of this issue as a "red herring," Opening Br. of SWRCB at 25, this Court finds that substantial bankruptcy issues preclude mandatory abstention in this case.

Mandatory abstention does not apply to core bankruptcy proceedings. See In re Chapman, 132 E.R. 153, 157 (Bankr. N.D. Ill. 1991). The present action qualifies as a core

proceeding pursuant to several subdivisions of 28 U.S.C. § 157(b), and for this reason also is not subject to mandatory abstention.

Section 157(b) (2) (A) provides the so-called "catchall" definition of a core proceeding. This provision states that "matters concerning the administration" of the bankruptcy estate qualify as core proceedings. Courts are cautioned to employ a narrow construction of this provision. See In re Castlerock, 781 F.2d 159, 162 (9th Cir. 1986). Counsel for the Trustee argue that the estate's claim against the Fund may constitute one of the largest assets of the estate; accordingly, the present action could be construed as having such a fundamental effect on the Trustee's ability to maintain and administer the estate that this action would fit within the § 157(b) (2) (A) "catchall" provision.

However, this Court finds that the present action replicates more than just the catchall core proceeding provision; section 157 (b) (2) (E) provides a basis for core proceeding jurisdiction where the proceeding involves the "turning over" of the property of the estate. Insofar as the present action involves claims against the Fund, into which the estate has previously paid monies and from which the Trustee is making demands, the present action seeks an order for the turning over of property of the estate pursuant to § 157(b)(2)(E).

2. Equitable Considerations Do Not Compel Abstention and Remand of This Proceeding.

The decision of whether to exercise discretionary abstention is guided by twelve factors identified by the Ninth Circuit in In re Tucson Estates, 912 F.2d 1162 (9th Cir. 1990).

The Tucson Estates factors include: (1) The effect or lack thereof on the efficient administration of the estate if a court recommends abstention; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficulty or unsettled nature of the applicable law; (4) the presence of a related proceeding commenced in state court of other nonbankruptcy court; (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334; (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case; (7) the substance rather than the form of an asserted core proceeding; (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court; (9) the burden of the bankruptcy court's docket; (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties; (11) the existence of a right to a jury trial; (12) the presence in the proceeding of nondebtor parties. Id. at 1167.

This Court finds that on balance, the Tucson Estate factors do not favor discretionary abstention and remand. This proceeding involves a substantial claim against the Fund; resolution of this matter will have a serious effect upon the Trustee's efficient administration of the estate under the first Tucson Estate factor. The third Tucson Estate factor also weighs strongly against abstention: whether the Trustee is disqualified by virtue of the prepetition debtor's acts is a complex issue of federal bankruptcy law that is best left to the bankruptcy court. These two factors alone justify a denial of the Motion for Remand or Abstention. Since neither mandatory nor equitable abstention doctrines apply in the present case, this Court finds that the bankruptcy court's denial of the SWRCB's Motion for Remand or Abstention was

proper. Accordingly, the Order of the bankruptcy court in Adversary No. 96 LA-01575 is **affirmed**.

E. Conclusion.

For the foregoing reasons, the order of the bankruptcy court denying SWRCB's Motion for Remand or Abstention in the Mandamus Adversary, No. LA-01575 is **affirmed** and the order of the bankruptcy court in the Tax Adversary, No. LA-02281 is **affirmed** with respect to the finding that fees to the Fund constitute taxes within the meaning of 11 U.S.C. 507(a)(8), and **reversed** with respect to the finding that the Fund is entitled to claim Eleventh Amendment sovereign immunity as an arm of the State of California.

In this Order, the Court is simply determining (1) the inability of the Fund to claim Eleventh Amendment immunity; (2) the characterization of Fund fees as taxes for purposes of § 507; and (3) the inappropriateness of mandatory or discretionary abstention with respect to the Mandamus Adversary. This Court makes no findings at the present time regarding (1) the amount of money, if any, the Fund may ultimately be compelled to pay the Trustee; or (2) the period of time, whether pre- or post- petition, for which the Trustee is entitled to seek reimbursement from the Fund. The matters appealed from are remanded to the bankruptcy court for further proceedings consistent with the Order of this Court.

IT IS SO ORDERED.

DATED: September 27, 1997

/s/ Dickran Tevrizian
Dickran Tevrizian, Judge
United States District Court

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

IN RE	
GARY LAZAR AND DIVINE GRACE LAZAR,	CASE NO. CV 97-4724 DT
Debtors,	CONSOLIDATED WITH
	CASE NO. CV 96-8324 DT
IN RE	BANKRUPTCY COURT CASE NUMBER LA 92-39039 SB; JOINTLY ADMINISTERED WITH LA 92-39042 SB
CALIFORNIA TARGET ENTERPRISES, INC., ET AL.,	
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CALIF. STATE WATER RESOURCES CONTROL BOARD, a board within Calif. Environmental Protection Agency, an agency of the State of California	ORDER **REVERSING IN PART AND AFFIRMING IN PART** THE BANKRUPTCY COURT'S ORDER DENYING PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT
Appellant,	
vs.	[CV 97-4724]

GEORGE E. SCHULMAN, CHAPTER 7 TRUSTEE,

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I. Background

A. Factual Background

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claims properly be removed to the bankruptcy court; (2) assuming the Fund is entitled to sovereign immunity under the Eleventh Amendment, has the Fund waived that immunity in this case?

II. Discussion

A. Standard of Review

Decisions of the bankruptcy court may be appealed to the district court pursuant to 28 U.S.C. § 158(a). On appeal, this Court employs a de novo standard of review with respect to issues of law decided by the bankruptcy court. In re Kashani, 190 B.R. 875, 881 (9th Cir. B.A.P. 1995).

B. Fees Paid into the Fund Are Taxes for Purposes of 11 U.S.C. § 507(a)(8).

Characterization of a financial charge or assessment as a "tax" for bankruptcy priority purposes is not dependent upon labels used under State law. In re Camilli, 94 F.3d 1330, 1331 (9th Cir. 1996). Instead, the Ninth Circuit has prescribed a four-part test for qualification of a charge as a tax. In order to constitute a tax, the charge must be (1) an involuntary pecuniary burden; (2) imposed by the state legislature; (3) for a public purpose; (4) under the police or taxing power. Id., citing In re Lorber Indus., 675 F.2d 1062, 1066 (9th Cir. 1982).

The Trustee contends that the bankruptcy court erred when it rules that fees payable to the Fund do not constitute "taxes" within the contemplation of 11 U.S.C. § 507(a)(8). In support of this contention, the Trustee relies heavily on Sinclair Paint Co. v. State Board of Equalization, 15 Cal. 4th 866, 64

Cal. Rptr. 2d 447 (1997), as well as the designation of the fees as "not taxes" in Cal. Health & S.C. § 25299.40. These California authorities, although not irrelevant, do not do away with the need for this Court to apply the Lorber standard in the present case. See Camilli, 94 F.3d at 1331. After applying Lorber to the fees in the present case, it becomes readily apparent that the fees constitute taxes for purposes of § 507, notwithstanding any contrary designation under state law.

The first prong of Lorber looks to whether the debt at issue is "an involuntary pecuniary burden." Lorber, 675 F.2d at 1066. In the present case, it is clear that fees paid to the Fund are involuntary. All permitted owners of underground storage tanks must pay their fees to the State Board of Equalization pursuant to Cal. Health & S.C. § 25299.41; tank owners have no choice in the matter. This differs from the charge at issue in the Lorber case, where a waste water discharger was forced to pay assessments based on the volume of waste discharged into the sewer. Lorber, 675 F.2d at 1064. The difference between Lorber and the present case is that the debtor in Lorber had alternatives; if the debtor had chosen not to discharge waste water into the sewer, the debtor would not have been liable for the assessment. In contrast, owners of storage tanks have no choice whether to pay fees to the Fund. Hence, the mandatory nature of § 25299.41 clearly meets the first prong of Lorber.

The second prong of Lorber requires that the debt involved must be imposed by the state legislature. Lorber, 675 F.2d at 1066. In the present case, fees paid to the Fund under § 25299.41 are undoubtedly imposed by legislative action.

The third prong of Lorber deals with the existence of a

public purpose for levying the charge. Lorber, 675 P.2d at 1066. In the present case, the fees are used to carry out the State's goal of cleaning up leaking petroleum tanks in order to safeguard the public health and welfare. The public purpose of such an enactment is readily apparent, and compares favorably to such enactments as the mining reclamation charges under 30 U.S.C. § 1201 et seq., held to be "taxes" under § 17 of the Bankruptcy Act in United States v. River Coal Co., 748 F.2d 1103, 1106 (6th Cir. 1984). Accordingly, this Court finds that the fees meet the third prong of Lorber. Also, in light of the fact that the legislative scheme authorizing the fees was passed in pursuit of a legitimate public purpose, the Court finds that the fees meet the fourth prong of Lorber, which looks to whether or not the charge is incurred pursuant to an exercise of the police or taxing power of the state. Lorber, 675 F.2d at 1066.

The Trustee argues that Cal. Health & S.C. § 25299.40 expressly characterizes fees payable to the Fund as not being taxes. However, as previously stated, the labeling of the fees as "not taxes" by the California legislature does not affect the nature of this Court's inquiry under Lorber. See Camilli, 94 F.3d at 1331. Hence, this Court **affirms** the finding of the bankruptcy court in Adversary No. LA 96-02281 that fees payable to the Fund under § 25299.41 constitute taxes for purposes of 11 U.S.C. § 507 (a)(8).

C. The Fund Is Not Entitled To Claim Immunity under the Eleventh Amendment.

In its denial of the Trustee's Motion for Summary Judgment in the Tax Adversary, the bankruptcy court did not state its reasons for finding that as a matter of law, the Fund is

entitled to Eleventh Amendment immunity. The Trustee contends that the nature of the Fund precludes treatment of the Fund as arm of the state for Eleventh Amendment purposes.

The SWRCB asserts in its Opening Brief that the Fund must be treated as an arm of the State under Mitchell v. Los Angeles Community College Dist., 861 F.2d 198 (9th Cir. 1988), cert. denied, 490 U.S. 1081 (1989). In Mitchell, the Ninth Circuit identified five factors that must be used in determining whether an entity is an arm of the state for Eleventh Amendment purposes: (1) whether a money judgment against the entity would be paid out of state funds; (2) whether the entity performs central government functions; (3) whether the entity may sue or be sued; (4) whether the entity has the power to take property in its own name or the name of the state; (5) the corporate status of the entity. Mitchell, 861 F.2d at 201. The Fund contends that it so clearly meets the first two Mitchell factors that it is entitled to Eleventh Amendment immunity.

The first Mitchell factor deals with whether a money judgment against the entity at issue would be paid out of state funds. The SWRCB contends that the designation of the Fund by Cal. Health & S.C. § 25299.50 as a part of the State Treasury favors the Fund's passing the first prong of Mitchell. However, 25299.50 is only one part of the legislative scheme creating the Fund. The Court finds that the scheme used to create the Fund prevents the Fund's assertion of Eleventh Amendment immunity.

It appears to this Court that the Fund is a self-supporting, self-maintaining entity, rather than a true creature of the State treasury. The contents of the Fund are

largely the fees paid by gas station owners. See Trustee's Excerpts of Record at 1088. Monies deposited in the Fund can only be expended for the limited purposes authorized by Cal. Health & S.C. § 25299.51, including the costs of cleaning up underground tank leakage and administrative costs. The Fund does not receive mandatory appropriations; "the State's commitment to pay claims [placed on the Fund] is contingent upon the availability of monies in the Fund." Trustee's Excerpt of Record at 1124.

As the SWRCB points out in its Opening Brief, depletion of monies in the Fund will result in the Fund having inadequate resources to pay claims, since the legislature is not required to transfer money into the Fund to cover a shortfall. See Cal. Govt. C. § 16351. Hence, the Fund itself, and not the State, bears ultimate liability for claims against the Fund. Bearing in mind that the "vulnerability of the State's purse" is one of the most significant factors in Eleventh Amendment determinations, Hess v. Port Auth. Trans-Hudson, 115 S. Ct. 394, 404 (1994), it appears to this Court that the Fund's failure to meet the first Mitchell prong is fatal to its claim of Eleventh Amendment immunity under these circumstances. The insulation of the State treasury's General fund from liability for claims against the Fund obviates the necessity for Eleventh Amendment immunity for the Fund. Accordingly, this Court reverses the finding of the bankruptcy court in Adversary No. LA 96-02281 that the Fund is entitled to claim immunity under the Eleventh Amendment.

Because this Court finds as a matter of law that the Fund is not entitled to immunity under the Eleventh Amendment, the issue of immunity waiver raised in the SWRCB appeal from the Mandamus Adversary, No. LA

96-01575 is moot.

D. Remand of the Mandamus Adversary Is Not Required.

1. Mandatory Abstention Under 28 U.S.C. § 1334(c)(2) Is Not Required.

Under 28 U.S.C. § 1334(c) (2), a bankruptcy court must abstain from hearing a proceeding "based upon a state law claim or a state law cause of action, related to a case under Title 11 but not arising under Title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section . . . if an action is commenced, and can be timely adjudicated, in a state forum of appropriate jurisdiction." This mandatory abstention provision is not applicable in the present case.

The present case implicates substantial issues of bankruptcy law. The SWRCB asserts that the Trustee cannot pursue claims against the Fund because its claims were formerly held by the Lazars; the Trustee contests this assertion. Resolution of this dispute is a substantial issue of federal bankruptcy law, for the bankruptcy court must determine whether the actions of the pre-petition debtors will be imputed to the Trustee. Therefore, notwithstanding SWRCB's dismissal of this issue as a "red herring," Opening Br. of SWRCB at 25, this Court finds that substantial bankruptcy issues preclude mandatory abstention in this case.

Mandatory abstention does not apply to core bankruptcy proceedings. See In re Chapman, 132 E.R. 153, 157 (Bankr. N.D. Ill. 1991). The present action qualifies as a core

proceeding pursuant to several subdivisions of 28 U.S.C. § 157(b), and for this reason also is not subject to mandatory abstention.

Section 157(b) (2) (A) provides the so-called "catchall" definition of a core proceeding. This provision states that "matters concerning the administration" of the bankruptcy estate qualify as core proceedings. Courts are cautioned to employ a narrow construction of this provision. See In re Castlerock, 781 F.2d 159, 162 (9th Cir. 1986). Counsel for the Trustee argue that the estate's claim against the Fund may constitute one of the largest assets of the estate; accordingly, the present action could be construed as having such a fundamental effect on the Trustee's ability to maintain and administer the estate that this action would fit within the § 157(b) (2) (A) "catchall" provision.

However, this Court finds that the present action replicates more than just the catchall core proceeding provision; section 157 (b) (2) (E) provides a basis for core proceeding jurisdiction where the proceeding involves the "turning over" of the property of the estate. Insofar as the present action involves claims against the Fund, into which the estate has previously paid monies and from which the Trustee is making demands, the present action seeks an order for the turning over of property of the estate pursuant to § 157(b)(2)(E).

2. Equitable Considerations Do Not Compel Abstention and Remand of This Proceeding.

The decision of whether to exercise discretionary abstention is guided by twelve factors identified by the Ninth Circuit in In re Tucson Estates, 912 F.2d 1162 (9th Cir. 1990).

The Tucson Estates factors include: (1) The effect or lack thereof on the efficient administration of the estate if a court recommends abstention; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficulty or unsettled nature of the applicable law; (4) the presence of a related proceeding commenced in state court of other nonbankruptcy court; (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334; (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case; (7) the substance rather than the form of an asserted core proceeding; (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court; (9) the burden of the bankruptcy court's docket; (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties; (11) the existence of a right to a jury trial; (12) the presence in the proceeding of nondebtor parties. Id. at 1167.

This Court finds that on balance, the Tucson Estate factors do not favor discretionary abstention and remand. This proceeding involves a substantial claim against the Fund; resolution of this matter will have a serious effect upon the Trustee's efficient administration of the estate under the first Tucson Estate factor. The third Tucson Estate factor also weighs strongly against abstention: whether the Trustee is disqualified by virtue of the prepetition debtor's acts is a complex issue of federal bankruptcy law that is best left to the bankruptcy court. These two factors alone justify a denial of the Motion for Remand or Abstention. Since neither mandatory nor equitable abstention doctrines apply in the present case, this Court finds that the bankruptcy court's denial of the SWRCB's Motion for Remand or Abstention was

proper. Accordingly, the Order of the bankruptcy court in Adversary No. 96 LA-01575 is **affirmed**.

E. Conclusion.

For the foregoing reasons, the order of the bankruptcy court denying SWRCB's Motion for Remand or Abstention in the Mandamus Adversary, No. LA-01575 is **affirmed** and the order of the bankruptcy court in the Tax Adversary, No. LA-02281 is **affirmed** with respect to the finding that fees to the Fund constitute taxes within the meaning of 11 U.S.C. 507(a)(8), and **reversed** with respect to the finding that the Fund is entitled to claim Eleventh Amendment sovereign immunity as an arm of the State of California.

In this Order, the Court is simply determining (1) the inability of the Fund to claim Eleventh Amendment immunity; (2) the characterization of Fund fees as taxes for purposes of § 507; and (3) the inappropriateness of mandatory or discretionary abstention with respect to the Mandamus Adversary. This Court makes no findings at the present time regarding (1) the amount of money, if any, the Fund may ultimately be compelled to pay the Trustee; or (2) the period of time, whether pre- or post- petition, for which the Trustee is entitled to seek reimbursement from the Fund. The matters appealed from are remanded to the bankruptcy court for further proceedings consistent with the Drder of this Court.

IT IS SO ORDERED.

DATED: September 29, 1997

/s/ Dickran Tevrizian
Dickran Tevrizian, Judge
United States District Court

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In re Gary Lazar; Divine Grace Lazar; California Target Enterprises, Inc.; Alameda Management Company, Inc.; Liberty Marketing Company, Inc.; P & M Service Stations, Inc.; Pronto Marketing Company; Inc.; Mission Marketing Group, Inc.; Good Guys Lube N' Tune, Inc.; Challenge Marketing Co., Inc.; California Target Supply, Inc.	)	
Debtor,	)	**ORDER**
George E. Schulman, Chapter 7 Trustee,	)	**(Filed April 20, 2001)**
Appellant-Cross-Appellee	)	
v.	)	
State of California; California State Water Resources Control Board; California Underground Storage Tank Cleanup Fund; John P. Caffre; James M. Stuchater; Mark Del Peiro; Mary Jane Forster; John W. Brown,	)	
Appellees-Cross-Appellants.	)	

Before: BROWNING, THOMAS, and WARDLAW, Circuit Judges.

The panel has voted to deny the petition for rehearing and reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing is DENIED and the suggestion for rehearing en banc is rejected.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

U.S. Const., Amend. XI:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

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11 U.S.C. § 106(b):

> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

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11 U.S.C. § 704(1):

> The trustee shall –
>
> (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest; . . .

---

28 U.S.C. § 1452(a):

(a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

Rule 13(a), Federal Rules of Civil Procedure:

(a) Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. . . .

Cal. Health & Safety Code § 25299.10:

(a) This chapter shall be known, and may be cited, as the Barry Keene Underground Storage Tank Cleanup Trust Fund Act of 1989.

(b) The Legislature hereby finds and declares all of the following:

(1) In order to help ensure an efficient petroleum underground storage tank cleanup program that adequately protects public

health and safety and the environment and provides for the rapid distribution of cleanup funds that will assist the state's recovery, it is in the best interest of the public that the board devote maximum effort to the expedited processing and payment of all claims filed pursuant to Sections 25299.57 and 25299.58.

. . .

(6) It is in the best interest of the health and safety of the people of the state to establish a fund to pay for corrective action where coverage is not available. . . .

Cal. Health & Safety Code § 25299.42(b), (c):

(b) The State Board of Equalization shall collect the fee imposed by this article commencing on the first day of the first calendar quarter which begins more than 90 days after the effective date of the act adding this article.

(c) The State Board of Equalization shall deposit all fees collected pursuant to this article in the Fund.

Cal. Health & Safety Code § 25299.50(a):

(a) The Underground Storage Tank Cleanup Fund is hereby created in the State Treasury. The money in the fund may be expended by the board, upon appropriation by the Legislature, for purposes of this chapter. From time to time, the board may modify existing accounts or create accounts in the fund or other funds administered by the board, which the board determines are appropriate or necessary for proper administration of this chapter.

Supreme Court, U.S.
FILED
SEP 12 2001
CLERK

(2)

No. 01-128

In The

Supreme Court of the United States

STATE OF CALIFORNIA, *et al.*,

Petitioners,

v.

GEORGE E. SCHULMAN, CHAPTER 7 TRUSTEE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICI CURIAE* STATES OF MONTANA, DELAWARE, HAWAII, MARYLAND, OHIO, TEXAS, UTAH, WEST VIRGINIA, COMMONWEALTH OF PUERTO RICO, TERRITORY OF GUAM IN SUPPORT OF PETITIONERS

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REASONS FOR GRANTING THE WRIT

I. THE NINTH CIRCUIT'S DECISION THREATENS THE STATES' ABILITY TO IMPOSE AND COLLECT TAXES.

The Ninth Circuit's decision to recognize California's action in filing a claim in the bankruptcy proceeding as an implied waiver of its sovereign immunity directly threatens the States' ability to collect and retain funds, including taxes and other debt. California, in this case, and any State for that matter, has no control over a debtor's choice of forum. Thus, the Ninth Circuit's decision potentially could be applied to any State that files a claim in bankruptcy court, not just those States physically situated within the boundaries of the Ninth Circuit.

The Ninth Circuit reads *Gardner v. New Jersey*, 329 U.S. 565 (1947), as working a blanket waiver of a state's sovereign immunity whenever a state files a proof of claim in bankruptcy. Pet's App. at 18-21. As a result, the Ninth Circuit focuses on the extent of California's waiver and its application to the "same transaction or occurrence" test. *Id.* The court misapplies the "logical relationship" test of Rule 13(a) of the Federal Rules of Civil Procedure, in finding that a proof of claim filed by the California Board of Equalization to collect unpaid taxes and underground-storage-tank fees logically relates to the debtor's claims for reimbursements from the underground-storage-tank fund for corrective actions taken on its underground storage tanks. Pet's App. at 23-25.

In doing so, the Ninth Circuit minimizes the "indignity" of subjecting a state to suit in federal court. *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996). State revenue

departments routinely file proofs of claim in bankruptcy to collect unpaid taxes. As this Court has noted, "[t]he power to tax 'is an incident of sovereignty. . . . ' " *International Harvester Co. v. Wisconsin Dept. of Taxation*, 322 U.S. 435, 444 (1944), *quoting McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 429 (1819). Restrictions imposed by the Ninth Circuit in this case on California's ability to impose and collect taxes, in the form of an overly liberal reading of the "same transaction or occurrence test," Pet's App. at 24, impugns California's sovereignty, and, in turn, the sovereignty of all States.

Indeed, the Ninth Circuit's decision actually rewards a tax scofflaw by granting it the ability to hale a state agency into federal court simply because the State has a proof of claim to recover unrelated state taxes from the bankruptcy estate. *See also In re Hughes-Bechtol, Inc.*, 124 B.R. 1007, 1018 (Bankr. S.D. Ohio 1991) (holding that state revenue department's filing of a proof of claim in bankruptcy permitted the debtor to proceed with counterclaim for breach of contract). This overly expansive view of the "same transaction or occurrence" test runs afoul of the notion that a State cannot waive its Eleventh Amendment immunity by implication. Such waiver must be "stated 'by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction." *Edelman v. Jordan*, 415 U.S. 651, 673 (1974) (*quoting Murray v. Wilson Distilling Co.*, 213 U.S. 151, 171 (1909)). *See also College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 676 (1999) (citing *Great N. Life Ins. Co. v. Read*, 322 U.S. 47, 54 (1944)). No such "overwhelming" showing of consent has

been made here. To the contrary, California vigorously resisted jurisdiction at every stage of the proceedings.

Moreover, as explained in *Seminole Tribe* and its progeny, neither the comprehensiveness of a federal power nor the desire for uniformity in a scheme of federal law, such as the "logical relationship" test of Rule 13(a) of the Federal Rules of Civil Procedure, overcomes the States' sovereign immunity. *Florida Prepaid Postsecondary Educ. Expense Bd. v. College Sav. Bank*, 527 U.S. 627, 647-48 (1999). In view of this precedent, "there is simply no principled basis to distinguish the Bankruptcy Clause from other Article I clauses" such as the Commerce or Patent clauses. *In re Sacred Heart Hosp. of Norristown*, 133 F.3d 237, 243 (3d Cir. 1998).

Further, what constitutes "logical" for purposes of Rule 13(a) of the Federal Rules of Civil Procedure and its concern for judicial economy, may not represent the same logic that determines whether a claim represents a permissible action for recoupment for purposes of sovereign immunity. *See Oklahoma Tax Commission v. Potawatomi Tribe*, 498 U.S. 505, 509 (1991) (holding that tribe's request for declaratory judgment did not constitute waiver of sovereign immunity for compulsory counterclaim under Rule 13(a)). Rule 13(a) of the Federal Rules of Civil Procedure makes no mention of any intent by Congress to abrogate the States' sovereign immunity as a matter of course.

II. THIS COURT'S EARLY DECISIONS RECOGNIZED THE BROAD SCOPE OF THE STATES' ELEVENTH AMENDMENT IMMUNITY.

The Court, in *Alden v. Maine*, 527 U.S. 706 (1999), provides a comprehensive picture of the founders' intent and understanding of State sovereign immunity at the time of the debates and ratification of the Constitution. 527 U.S. at 716-24. "The generation that designed and adopted our federal system considered immunity from private suits central to sovereign dignity." 527 U.S. at 715. The founders' writings and speeches demonstrate the general understanding of the time that States would continue to enjoy immunity from suit. 527 U.S. at 716-24.

Advocates of the Constitution repeatedly assured the people "in no uncertain terms that the Constitution would not strip the States of sovereign immunity." 527 U.S. 716. For example, in *The Federalist No. 81*, Alexander Hamilton carefully distinguished "an alienation of State sovereignty," which he had discussed in *The Federalist No. 32*, from State sovereign immunity. He argues that "there is no color to pretend that the State governments would, by the adoption [of the Constitution], be divested of the privilege [of sovereign immunity]. . . . " *The Federalist No. 81*, at 487-88 (Alexander Hamilton) (Clinton Rossiter, ed. 1961); 527 U.S. at 717. Hamilton clearly sought to quell the fear that sovereign immunity would be sacrificed if the constitution were ratified, and so distinguished the alienation of state sovereignty inherent in conceding certain aspects of law-making *authority* to Congress from the

ceding of sovereign *immunity* to suit in federal courts by private individuals to enforce those laws.[1]

Other supporters at the various state ratifying conventions also assured the States that they could not be sued in federal court. Both James Madison and John Marshall spoke at the Virginia ratifying convention, supporting the understanding that a State would not be sued without its consent. 527 U.S. 717-18; Jonathon Elliot, *Debates on the Federal Constitution* 533, 555 (2d ed. 1854). The New York and Rhode Island conventions expressly proclaimed that their understanding of the Constitution did not include the ability of private persons to sue the State. 527 U.S. 718-19; Elliot, *Debates* at 336, 329.

And when, just five years after the Constitution had been ratified, the Court in *Chisholm v. Georgia*, 2 U.S. (2 Dall.) 419 (1793), held that a private citizen of another

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[1] As Hamilton made clear in *The Federalist No. 32*, the degree of alienation of sovereignty could vary widely. In some instances, such as naturalization of foreign citizens the federal government would wholly occupy the field; in others, such as taxation, both a federal and state scheme could exist. Bankruptcy is a field where for at least half of the nation's history, there was no federal insolvency law at all, and states were the only active regulators of the field. With or without a federal law, states remain able to regulate treatment of insolvent parties, subject only to the constraints of the Impairment of Contracts Clause and the need to recognize the supremacy of federal substantive law if conflict exists. *See Sturges v. Crowninshield*, 17 U.S. 122 (1819) and *In re Newport Offshore*, 219 B.R. 341 (Bankr. D.R.I., 1998). Those substantive limitations on state law are wholly separate, though, from the question of federal court *jurisdiction* over state actions in the bankruptcy context.

State could sue the State of Georgia, the decision "fell upon the country with a profound shock" as it went against the deeply held consensus of the time. 527 U.S. at 720, *quoting* 1 C. Warren, *The Supreme Court in United States History 96* (rev. ed. 1926); *accord Hans v. Louisiana*, 134 U.S. 1, 11 (1890); *Principality of Monaco v. Mississippi*, 292 U.S. 313, 325 (1934); *Seminole Tribe*, 517 U.S. at 69. The press and the States responded with outrage. 527 U.S. at 720. It took Congress just one day to introduce a proposal to amend the Constitution to reverse *Chisholm's* result. 527 U.S. at 721, *citing* 4 *Annals of Cong.* 25, 30, 477, 499 (1794). Congress eventually passed the Eleventh Amendment with only one day's debate in each house. 527 U.S. at 721, *citing* 4 *Annals of Cong.* at 30-31, 476-78. The state ratified the Eleventh Amendment within two years time – a record of speed that appears unequaled by any other amendment since that time.

III. THIS COURT'S RECENT DECISIONS CONFIRM THAT NO ARTICLE I POWER HELD BY CONGRESS, INCLUDING THE BANKRUPTCY CLAUSE, REPRESENTS A CESSION OF A STATE'S SOVEREIGN IMMUNITY FROM SUIT IN FEDERAL COURT.

Modern decisions of this Court confirm that, although Article I of the Constitution may have granted Congress the power to pass laws regarding certain subjects, it did not abolish in any way the States' sovereign immunity from suit. Indeed, *Seminole Tribe* makes clear that the extent to which the States may have ceded their

law-making authority in certain fields to the federal government does not enhance Congress' power to abrogate sovereign immunity in the judicial arena.

The *Seminole Tribe* Court compared the Indian Commerce Clause, at issue in that case, with the Interstate Commerce Clause, at issue in *Pennsylvania v. Union Gas Co.*, 491 U.S. 1 (1988). The Court concluded that "[i]f anything, the Indian Commerce Clause accomplishes a greater transfer of power from the States to the Federal Government than does the Interstate Commerce Clause." 517 U.S. at 62.

Similarly, the Interstate Commerce and Indian Commerce Clauses arguably accomplish greater transfers of power from the States to the federal government than does the Bankruptcy Clause. The absence of a "dormant" bankruptcy power, similar to the "dormant" Interstate Commerce Clause, bolsters this point. *See Sturges v. Crowninshield*, 17 U.S. 122 (1819) (finding that state could pass insolvency laws in absence of any action by Congress in the field). Moreover, the requirement that the bankruptcy laws must be uniform can be viewed as a constraint on the federal legislative power that does not exist with respect to the Commerce Clause.

Seminole Tribe unequivocally overruled the assertion in *Union Gas* that the degree of cession of legislative authority to Congress conveyed a concomitant cession of judicial authority to the federal courts. 517 U.S. at 62. In so doing, the Court held that Article I powers, regardless

of the sweeping breadth of authority that they may convey to Congress, do not remove the States' sovereign immunity, and they do not give to Congress the power to abrogate it. The Court has repeated this holding in *Florida Prepaid* (the Interstate Commerce and Patent Clauses), and *College Savings Bank* (the Interstate Commerce Clause). If the States did not cede their immunity in the plan of the convention with regard to the all-encompassing Indian and Interstate Commerce powers, then, even more surely, they did not with regard to the Bankruptcy power. "[T]here is simply no principled basis to distinguish the Bankruptcy Clause from other Article I clauses for purposes of sovereign immunity. *In re Sacred Heart Hospital of Norristown*, 133 F.3d 237, 243 (3d Cir. 1998).

Likewise, the understandable need for "uniformity" in bankruptcy laws works no exception to the *Seminole Tribe* rule. In analyzing the Fourteenth Amendment power, the *Florida Prepaid* Court pointed out that one of Congress's main motivations in making States amenable to suit in federal patent court was to avoid the "patchwork of State laws . . . undermining the goal of national uniformity in our patent system." *Florida Prepaid*, 527 U.S. 644-45, *quoting* H.R. Rep. No. 101-960, pt. 1, p. 38. The Court held that "the need for uniformity in the construction of patent law is undoubtedly important, but that is a factor which belongs to the Article I patent-power calculus," rather than the availability of state sovereign immunity. *Florida Prepaid*, 527 U.S. at 645.

Similarly, the need for uniformity in the construction of bankruptcy law is undoubtedly important as well, but cannot override the sovereign immunity of the States. As with the patent law, "to place States on the same footing

as private parties" under the bankruptcy regime may be desirable as a "proper Article I concern," but it is neither a reason nor a rationale for finding that the States ceded sovereign immunity in matters of bankruptcy. 527 U.S. at 647. The courts consistently have held that the "uniformity" requirement refers solely to *geographic* uniformity – a concept not at all affected by the recognition of retained state sovereignty from suit.

CONCLUSION

For the foregoing reasons, the State of California's petition for certorari should be granted.

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No. 01-128

IN THE

Supreme Court of the United States

STATE OF CALIFORNIA, *et al.*,

Petitioners,

v.

GEORGE E. SCHULMAN, CHAPTER 7 TRUSTEE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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COUNTER STATEMENT OF STATUTORY PROVISIONS INVOLVED

Petitioners incorrectly assert that this case involves 11 U.S.C. § 106(b). *See* Petition for a Writ of Certiorari ("Pet.") at 2. Elsewhere, however, Petitioners correctly acknowledge that the court of appeals did not rely on that statute in making its Eleventh Amendment holding here. Pet. at 8 n.3. According to one circuit panel, that statute has no effect on Eleventh Amendment sovereign immunity despite the statute's clear terms.[1] *See Arecibo Community Health Care, Inc. v. Puerto Rico*, 244 F.3d 241, 245 (1st Cir. 2001), *panel reh'g granted*, No. 00-1774 (1st Cir. June 7, 2001). As shown below, here the court of appeals applied settled principles of sovereign immunity waiver quite apart from that statute. Like the court of appeals, this Court therefore need not consider the validity or effect of § 106(b).

COUNTER STATEMENT OF THE CASE

The decision of the court of appeals proclaims no new rule of law and conflicts with no decisions of this Court or of any circuit. Following the holdings of two other circuits (the Fourth and Seventh), the Ninth Circuit here held that, for purposes of counter-claims against a State that seek only recoupment to reduce the amount of the State's own claim,

1. The statute provides:

> A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

"the state waives its Eleventh Amendment immunity with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence as the state's claim." Pet. App. at 20 (following *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140, 1148 (4th Cir. 1997); *Jones v. Yorke (In re Friendship Med. Ctr., Ltd.)*, 710 F.2d 1297, 1301 (7th Cir. 1983)). In making that uncontroversial holding, the court specifically declined to decide the question that Petitioners now ask this Court to address: whether a federal court may infer consent to a claim against the State "that is *not* in the nature of defensive recoupment to the State's claim[.]" Pet. at i (emphasis added).

Rather than resolving that constitutional question, the court of appeals rightly concluded that it "need not be addressed here" because the $4 million claims that Respondent George E. Schulman (the "Trustee") asserts against California actually seek less money than the State's $13 million claims arising from the same transactions or occurrences. Pet. App. at 20-21. As Petitioners actually acknowledged to the court of appeals,

> when a State files a proof of claim, it *does* consent to the bankruptcy court determining a recoupment claim arising out of the "same transaction or occurrence["] as the State's proof of claim and which is only asserted defensively to defeat [or] diminish the State's claim. This principle is recognized in established Eleventh Amendment jurisprudence.

Combined Reply and Cross Appeal Answering Brief of Appellants/Cross-Appellees State of California and California State Water Resources Control Board

and California Underground Storage Tank Cleanup Fund, at 44 (June 10, 1998) (emphasis in original). Despite that concession in June 1998, Petitioners now urge that the court of appeals erred in applying that rule, which supposedly conflicts with this Court's opinions in an earlier case (decided in 1991) and in the later case of *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999). Pet. at 12-15. Nothing in the proposed Question Presented fairly ~~encom~~passes that mistaken argument.

Petitioners properly do not seek review of the fact-specific holding that the Trustee's claims indeed arise from the same transaction or occurrence that gives rise to some of the State's claims, as required for the Trustee to assert a defensive recoupment claim. At least until the lower courts have adjudicated the merits of California's $13 million claims and the Trustee's counter demands for $4 million, there is no reason to suppose that the amount of the Trustee's claims will go beyond defeating or diminishing the related State claims. Accordingly, there is also no reason to conclude that this Court's review of the proposed Question Presented about hypothetical non-recoupment claims will affect the result of the case. Certiorari to consider that proposed question is therefore unwarranted. *See The SS Monrossa v. Carbon Black Export, Inc.*, 359 U.S. 180, 184 (1959) (dismissing certiorari for review of question that would not change the result).

I. Facts

The court of appeals summarized the claims asserted by and against various California agencies, together with the factual circumstances leading to those claims. *See* Pet. Appendix ("App.") at 4-7. Respondent is the trustee of the

bankruptcy estates of Mr. Gary Lazar, Ms. Divine Grace Lazar, and nine corporations that they owned and controlled (collectively, "the Lazars"). In related criminal proceedings, the Lazars pleaded *nolo contendere* and were sentenced for felony violations of state environmental laws in falsifying required reports of tests for leaks from underground storage tanks ("USTs") for holding gasoline. ER 00267.[2] The district court initially appointed the Trustee to represent the interests of the estates in reorganizing their affairs under Chapter 11 of the Bankruptcy Code; later, when the bankruptcy court converted the proceedings to a liquidation under Chapter 7, that court then appointed the Trustee to administer the estates for the benefit of their creditors. ER 00006.

The Trustee asserted claims against the California Underground Storage Tank Cleanup Fund (the "Fund") and against the California State Water Resources Control Board (the "Water Board"). The Water Board administers the Fund, which consists of fees from filling stations that use USTs. Paying such fees to the Fund is mandatory for obtaining a permit from the Water Board, as required to use a UST in California. Cal. Health & Safety Code § 25299.41. The Lazars (and later, the Trustee) obtained permits to use USTs at filling stations by making payments into the Fund. TRA Tab 7 pp. 1372-73. When a UST at a permitted filling station has leaked, the operator may seek reimbursement from the Fund for costs of cleaning up environmental contamination. Cal. Health & Safety Code § 25299.54. Only the Fund, and not the California treasury, pays such claims:

> Any claim filed against the fund pursuant to this article may be paid only out of the fund.

2. "ER" means Petitioners' Excerpts of Record on Consolidated Appeals, filed in the court of appeals on March 17, 1998.

> This chapter does not authorize the payment by the state of any additional amount with respect to any claim out of any source other than the fund.

Cal. Health & Safety Code § 25299.60(b).

II. Bankruptcy Proceedings

Before seeking bankruptcy protection, the Lazars had submitted roughly $4 million in claims to the Fund for reimbursement of costs incurred to correct leaks from their USTs. ER 0008-09. When the Fund rejected those claims (following the filing of these bankruptcy cases), the Trustee commenced an action against the Water Board and its members in a California trial court. That action sought to compel the Water Board to direct the Fund to pay those claims, together with damages and attorneys fees. ER 00024-25. The Trustee then immediately removed the action to the bankruptcy court, as provided by 28 U.S.C. § 1452(a) (authorizing any party, including a plaintiff, to remove an action to the bankruptcy court).

Meanwhile, the California State Board of Equalization (the "Board of Equalization") submitted proofs of claims seeking payment of at least $13 million that the Lazars allegedly owed the Fund. Pet. App. at 21. The Board of Equalization has statutory authority to file claims for unpaid UST fees for the Fund. *See* Cal. Health & Safety Code § 25299.42; Cal. Rev. & Tax Code §§ 50106, 50108. California also asserted other claims – unrelated to the Fund – seeking $31 million in taxes from the estate. *See* Pet. App. at 21 n.11.

The Water Board and its members moved the bankruptcy court to remand the Trustee's action seeking to compel

reimbursement of UST expenses from the Fund. Among other grounds, they urged that the Eleventh Amendment precludes federal court jurisdiction. The bankruptcy court denied that motion in September 1996. Pet. App. at 93-94. The Water Board appealed.

While the appeal of the Eleventh Amendment ruling was pending in the district court, in August 1997 the bankruptcy court denied the Trustee's request for an order compelling the Water Board to order payment from the Fund. Instead, the court granted the Trustee more limited relief. The court remanded the proceeding to the Water Board to allow the board to receive further evidence and to make an analysis of each claim against the Fund. The court also instructed the Water Board not to impute the Lazars' misconduct to the Trustee. ER 00446-47.[3] Additionally, the court found that the Water Board's procedures had violated the requirements of Fourteenth Amendment due process and the procedural requirements of California administrative law by denying the Trustee an opportunity to see the evidence against the Lazars and to present his own evidence. ER 00440-43. The court also held that the Water Board had failed to explain its reasons for decision, as required by Cal. Code Civ. Proc. § 1094.5, and that there was insufficient evidence to support that decision as a matter of law. ER 00443-45. The Water Board (and its individual members) appealed that order to the district court.

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3. *See generally FDIC v. O'Melveny & Myers*, 61 F.3d 17 (9th Cir. 1995) (per curiam) (holding that, under California equitable principles, a receiver of a debtor's assets is not charged with the debtor's inequitable conduct because the receiver represents the interests of the debtor's creditors – not the debtor itself).

Shortly after the bankruptcy court ordered that relief in August 1997, in September 1997 the district court affirmed the decision that the Water Board was not entitled to Eleventh Amendment immunity. Pet. App. at 95. Petitioners then appealed the Eleventh Amendment ruling to the Ninth Circuit. In December 1997 the district court stayed the order against the Water Board pending the outcome of that Eleventh Amendment appeal. The court also stayed further federal proceedings regarding that order, including the appeal of the merits that was pending in the district court. *See* App., *infra*.

Following the Ninth Circuit's resolution of the Eleventh Amendment issues, the district court has ordered the parites to attend a status conference regarding the Water Board's appeal on the merits. That status conference is scheduled to be held on September 24, 2001.

III. Proceedings in the Court of Appeals

The court of appeals held that California had waived its Eleventh Amendment immunity as to the Trustee's claims against the Water Board when the State's Board of Equalization filed proofs of claims for the Fund in the bankruptcy proceeding. The court concluded that filing such a proof of claim waives the immunity at least with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence. Pet. App. at 20.

The court also acknowledged a disagreement in the circuits regarding whether the scope of such a waiver is limited to counter demands that are in the nature of recoupment, or includes claims seeking an affirmative recovery from the State. Pet. App. at 17-20. The court left that question for another day, noting that it need not resolve

the disagreement in the circuits in this case. Because the estate's claims were slightly over $4 million and the Board of Equalization's proof of claim was at least $13 million in taxes payable to the Fund, the court reasoned, the estate did not seek affirmative recovery beyond the amount of the State's proof of claim. Pet. App. at 20-21.

The court of appeals also held that the Trustee's $4 million claims arose from the same transaction or occurrence as the State's $13 million claims because of the fact that the Trustee sought reimbursement from the Fund for corrective actions taken on underground storage tanks while that the Board of Equalization demanded payments of fees to the Fund. Pet. App. at 24-25. The court addressed and rejected the Water Board's contention that resolution of the Board of Equalization's claims and the Trustee's claims involved wholly separate inquiries. *Id.* at 23. The court noted that both sets of claims concerned the Fund, and both arise out of activities associated with the same bankruptcy case. *Id.* at 23-24. Therefore, the court held, the Trustee's claims against the Water Board were logically related to the proofs of claims filed by the Board of Equalization for unpaid UST fees. Pet. App. at 24.

The Ninth Circuit also addressed – but declined to resolve – the parties' disagreement over whether 11 U.S.C. § 106 precludes Eleventh Amendment immunity in a bankruptcy case like this one. Pet. App. at 25-27. Said the court, "[b]ecause we have determined that the state waived its Eleventh Amendment immunity rendering permissible the estate's counterclaim against the state, we refrain from reaching the constitutionality of sections 106(a) or (b)." Pet. App. at 26-27.

The court of appeals denied Petitioners' request for panel rehearing and rejected their suggestion for en banc consideration. In doing so, the court noted that "no active judge has requested a vote on whether to rehear the matter en banc." Pet. App. at 122.

REASONS FOR DENYING THE WRIT

Resolving the proposed Question Presented about the waiver of immunity as to non-recoupment claims may not affect the outcome of this case. For that reason alone, the Court should deny the request for a writ of certiorari. *See* I, *infra*. Moreover, Petitioners' arguments attacking the holding that the Trustee's claims actually *are* in the nature of recoupment do not support that request for certiorari. *See* II, *infra*. The Court should deny the Petition.

I. Petitioners' Question Presented Is Irrelevant to the Result in this Case.

Contrary to Petitioners' assertions, the record in this case simply does not raise their proposed Question Presented. That question only concerns waiver of immunity as to claims against the State that are "*not* in the nature of defensive recoupment to the State's claim." Pet. at i (emphasis added). But, as the court of appeals correctly determined, the Trustee's federal court claims do not exceed California's related claims. To the contrary, California's claims for fees allegedly owed to the Fund far exceed the Trustee's related claims for reimbursement from the Fund. Currently, therefore, the Trustee's claims *are* recoupment claims – and there is no reason for this Court to decide whether California has waived its Eleventh Amendment immunity as to claims that are *not* recoupment claims.

This Court has long recognized that "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded." *Bull v. United States*, 295 U.S. 247, 262 (1935). Because a recoupment claim is defensive in nature, the sovereign is "liable . . . to respond" to such a claim. *Id.* at 263 (rejecting sovereign immunity of the United States).[4] A State waives any Eleventh Amendment immunity to the assertion of defenses when the State voluntarily invokes the jurisdiction of a federal court by asserting a claim in bankruptcy. *Gardner v. New Jersey*, 329 U.S. 565, 573-74 (1947). Not surprisingly, therefore, every Circuit that has addressed the issue has held that a State waives its Eleventh Amendment immunity as to counter demands in the nature of recoupment. *See* Pet. App. at 18; *Schlossberg*, 119 F.3d at 1148; *Jones*, 710 F.2d at 1301.

The Ninth Circuit's holding here does not conflict with *Gardner* or any other decision of this Court or of another Circuit. Petitioners mistakenly argue otherwise by citing to portions of the Ninth Circuit's opinion in which the court of appeals *discussed* – but did not purport to *resolve* – apparently conflicting decisions of other Circuits regarding non-recoupment claims. *See* Pet. at 8 (relying on that discussion to demonstrate the existence of a holding

4. *See also e.g., Miller v. Tony & Susan Alamo Found.*, 134 F.3d 910, 916 (8th Cir. 1998) ("when the United States brings a claim in court, it 'waives immunity as to claims of the defendant which assert matters in recoupment – arising out of the same transaction or occurrence which is the subject matter of the Goverment's suit.' ") (citations omitted); *United States v. Forma*, 42 F.3d 759, 765 (2d Cir. 1994) ("Despite sovereign immunity, 'a defendant may, without statutory authority, recoup on a counterclaim an amount equal to the principal claim.' ") (quoting *United States v. United States Fidelity & Guar. Co.*, 309 U.S. 506, 511 (1940)).

by the Ninth Circuit that would warrant certiorari here); *see also id.* at 4, 11-12 (also asserting that that discussion constitutes the holding of the court of appeals in this case). Those supposedly conflicting decisions are irrelevant here because, as the Ninth Circuit correctly held, the issue of waiver as to non-recoupment claims "need not be addressed here." Pet. App. at 20-21. This is so because the $4 million claims that the Trustee asserts against California actually seek less money than the State's $13 million claims arising from the same transaction or occurrence. *Id.*

To be sure, it is possible that future developments could raise the proposed Question Presented by allowing the Trustee to obtain affirmative relief, beyond a claim in recoupment. This could occur only following a series of events that may or may not come to pass. For example, the Trustee could ultimately obtain affirmative relief: (1) if the bankruptcy court's order granting limited relief on the merits of the Trustee's claims survives the State's current appeal to the district court and any further appellate review by the court of appeals and by this Court; (2) if the Water Board on remand then denies the Trustee's claims against the Fund for a second time; (3) if the Trustee then files (and removes to the bankruptcy court) a new action seeking additional relief; and (4) if the lower federal courts also decide – for reasons entirely apart from such a new action by the Trustee – that California is entitled to collect less from the estate than the amount that the Trustee seeks (or is entitled to collect) from the Fund. If all those events were to occur then it would become necessary to decide whether California is immune from affirmative recovery, beyond recoupment, under the Eleventh Amendment. But in the absence of such developments it would be idle for this Court to decide whether a State's voluntary filing of a bankruptcy claim

allows affirmative relief based on a counter demand arising from the same transaction or occurrence. Instead, deciding that question "can await a day when the issue is posed less abstractly." *The SS Monrosa*, 359 U.S. at 184.

II. Petitioners' Arguments Attacking the Court of Appeals' Standard for Recoupment Claims – the "Same Transaction or Occurrence" Standard – Do Not Warrant Certiorari.

None of the other arguments contained in the Petition support the request for review of Petitioners' proposed Question Presented. In attempting to support that request, they assert that the Ninth Circuit departed from this Court's precedent by applying the "same transaction or occurrence" standard contained in Rule 13(a), Fed. R. Civ. P., to identify a counter demand against the State that is subject to waiver. That Rule 13(a) standard governs the assertion of compulsory counterclaims generally, and Petitioners urge that applying the same standard to identify recoupment claims subject to a waiver of Eleventh Amendment immunity conflicts with *College Savings Bank*, 527 U.S. at 680, and *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505, 509-10 (1991). Pet. at 12-15. According to Petitioners, the "same transaction or occurrence" standard applied by the Ninth Circuit here supposedly "flies in the face of an unbroken line of cases dating back for almost a hundred years demanding the application of a stringent standard." *Id.* at 14. All of those assertions are wrong, and none of them warrants certiorari.

Apart from saying that the court of appeals applied the *wrong* standard, Petitioners do not attempt to identify the *right* standard that supposedly should have been applied to

decide whether the Trustee's claims are recoupment claims. The Ninth Circuit's standard is entirely consistent with precedent that precedes the 1937 adoption of Rule 13(a) and the Federal Rules of Civil Procedure. *See Bull*, 295 U.S. at 262 ("recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded"). And Petitioners make no effort to reconcile their current challenge to that standard with their acknowledgment to the Ninth Circuit in June 1998 that "when a State files a proof of claim, it *does* consent to the bankruptcy court determining a recoupment claim arising out of the 'same transaction or occurrence[']' as the State's proof of claim" under "established Eleventh Amendment jurisprudence." Petitioners never urged the court of appeals to abandon that "established" standard.

In the absence of exceptional circumstances, this Court does not ordinarily consider arguments that a litigant neglected to make below. *See, e.g., City of Springfield v. Kibbe*, 480 U.S. 257, 258 (1987) (per curiam) (dismissing certiorari). There are no such circumstances here. Nothing in the *College Savings Bank* decision, rendered in June 1999 after Petitioners had filed their June 1998 appellate brief, warrants consideration of Petitioners' new (and erroneous) argument. Petitioners never urged that *College Savings Bank* warranted retracting their statement in the June 1998 brief. In seeking rehearing of the panel decision, Petitioners merely asserted – without relying on *College Savings Bank* – that the "same transaction or occurrence" standard should not have been applied "liberally" to these circumstances.[5]

5. Petition for Rehearing and Suggestion for Rehearing En Banc [FRAP 35, 40], at 10 (Feb. 2, 2001). Petitioners cited *College Savings Bank* once in requesting rehearing, saying only that "the continuing validity of *Gardner* was recently reaffirmed by the Supreme Court in *College Savings Bank*. . . ." *Id.* at 6.

Moreover, nothing in *College Savings Bank* or the earlier decision in *Potawatomi Indian Tribe* impugns the "same transaction or occurrence" standard for identifying recoupment claims. *College Savings Bank*, unlike this case and other cases that involve defensive recoupment, was not "a case in which the State has affirmatively invoked our [federal] jurisdiction." 527 U.S. at 676 (recognizing that affirmatively invoking federal jurisdiction does constitute a waiver of immunity). That case involved the federal copyright statutes and whether a State " 'impliedly' or 'constructively' " waived its immunity, *id.*, by voluntarily electing to engage in federally regulated conduct where Congress has provided that doing so will subject the State to suit, *id.* at 884. *College Savings Bank* has nothing whatsoever to do with recoupment claims. Likewise, *Potawatomi Indian Tribe* also did not involve recoupment claims. The sovereign tribe in that case did not assert any claim for money, and for this reason no counter demand seeking money could have operated as a defensive recoupment claim. The tribe sought only an injunction against being made to *pay* money; it did not seek to *collect* any money. *See* 498 U.S. at 507.

Petitioners properly do not seek review of the case-specific holding that, under the "same transaction or occurrence" standard, California has waived its Eleventh Amendment immunity as to the Trustee's recoupment claims here. This Court rarely reviews "the misapplication of a properly stated rule of law." Sup. Ct. R. 10. Nevertheless, in seeking review of their proposed Question Presented, Petitioners urge that the Ninth Circuit erred by applying that standard in a "liberal" way. Pet. at 8; *see also id.* at 13 (contending that the Ninth Circuit "utilized an 'increasingly liberal' test"). Petitioners are wrong. The court of appeals applied the legal standard in a way that is entirely consistent

with this Court's 1935 analysis of sovereign immunity in *Bull*, 295 U.S. at 262-63 (holding that the government's claim for income taxes was sufficiently related to the taxpayer's counter demand for a refund of estate tax payments because both claims involved taxation of proceeds from a single fund). In applying that correctly-stated legal standard, the court of appeals merely acknowledged that a 1966 decision had said that the term " 'transaction . . . gets an increasingly liberal construction.' " Pet. at 24 (quoting *Albright v. Gates*, 362 F.2d 928, 929 (9th Cir. 1966)). As *Albright* correctly observed over three decades ago, "[t]wo bundles of facts seldom are identical for comparing 'transactions,' and so close judgments must be made from time to time." 362 F.2d at 929 (deciding the scope of "ancillary" federal jurisdiction over claims against non-diverse parties). The Ninth Circuit's judgment of the facts in this particular case does not warrant certiorari.

Quite apart from the lack of exceptional circumstances to justify considering Petitioners' new and erroneous argument that the Ninth Circuit supposedly departed from this Court's century-old recoupment standard, that argument also is not before the Court for another reason. "Only the questions set out in the petition, or fairly included within them, will be considered by the Court." Sup. Ct. R. 14.1(a). Here, the Question Presented only concerns whether to find a waiver of immunity as to a claim "that is *not* in the nature of defensive recoupment to the state's claims." Pet. at i (emphasis added). Nothing in that question fairly includes the standard for identifying claims that *are* in the nature of defensive recoupment. "A question which is merely 'complementary' or 'related' to the question presented in the petition for certioari is not 'fairly included therein.' " *Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510

U.S. 27, 31-32 (1993) (per curiam). Needless to say, merely arguing such an issue in the text of the petition, as Petitioners do here, does not suffice. *Izumi*, 510 U.S. at 32 n.5. Because Petitioners' arguments about the standard for identifying recoupment claims are – at best – "complementary" or "related" to the question of waiver as to non-recoupment claims, the Court will not consider the Ninth Circuit's purported errors in stating and in applying that standard.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA GRANTING MOTION OF STATE OF WATER RESOURCES CONTROL BOARD AND CALIFORNIA UNDERGROUND STORAGE TANK CLEANUP FUND FOR STAY OF PROCEEDINGS PENDING APPEAL DATED AND FILED DECEMBER 15, 1997

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE NO. CV 97-4724 DT
CONSOLIDATED WITH
CASE NO. CV 96-8324 DT

(BANKRUPTCY COURT CASE NUMBER LA 92-39039 SB;
JOINTLY ADMINISTERED WITH LA 92-39042 SB)

APPEAL FROM:
ADV. NO. LA 96-01575 SB
CONSOLIDATED WITH
ADV. NO. LA 96-02281 SB

IN RE

GARY LAZAR AND DIVINE GRACE LAZAR,

Debtors,

IN RE

CALIFORNIA TARGET ENTERPRISES INC., ET AL,

Debtors,

Appendix

GEORGE E. SCHULMAN, CHAPTER 7 TRUSTEE,

Appellant,

vs.

STATE OF CALIFORNIA; CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, ET AL.

Appellee

ORDER **GRANTING** MOTION OF STATE WATER RESOURCES CONTROL BOARD AND CALIFORNIA UNDERGROUND STORAGE TANK CLEANUP FUND FOR STAY OF PROCEEDINGS PENDING APPEAL

[CV 97-4724]

I. Background

A. Factual Background

The underlying bankruptcy cases are nine substantively consolidated cases filed by corporations under the control of Divine Grace Lazar and Gary Lazar, administered along with the Lazar's personal bankruptcy cases. The Lazars and their entities held interests in about 200 retail gasoline stations. George Schulman (the "Trustee") was appointed as the Chapter 11 Trustee in 1994, and the next year the cases were converted to Chapter 7 cases. Mr. Schulman was then appointed as Chapter 7 Trustee. The Lazars are currently serving prison sentences for environmental crimes in

connection with operation of the gasoline stations. The tanks at those stations appeared to be older and prone to leakage, a major environmental hazard. The California Underground Storage Tank Cleanup Fund (the "Fund"), which is administered by the State Water Resources Control Board ("SWRCB"), assists gas station owners with costs of corrective action for such environmental hazards.

B. Procedural Posture

On July 9, 1997, this Court issued an Order consolidating the appeals in CV 97-4724 DT, an appeal from Adversary No. LA 96-02281 ("Tax Adversary"), and CV 96-8324 DT, an appeal from Adversary No. LA 96-01575 ("Mandamus Adversary"). The Tax Adversary was originally commenced by the Trustee against the SWRCB and other defendants seeking subordination of claims, damages, and recovery of allegedly improper payments. The Tax Adversary incorporated the Mandamus Adversary, which was an earlier Petition for Administrative Mandamus or Other Alternative Writ that the Trustee had filed to resolve a dispute regarding the SWRCB's decision to deny twenty claims brought upon the Fund by the debtors.

In the Tax Adversary, the Trustee appealed the June 6, 1997 Order of the bankruptcy court denying his Motion for Summary Judgment. The issues on which the Trustee sought Summary Judgment were: (1) are fees paid into the Fund by service station owners "taxes" for bankruptcy purposes?; (2) is the Fund an arm of the State of California that is entitled to assert Eleventh Amendment sovereign immunity?

Appendix

In the Mandamus Adversary, the SWRCB appealed the November 27, 1996 Order of the bankruptcy court denying remand of the administrative mandamus proceedings to state court. The issues on appeal in the Mandamus Adversary were: (1) may a state court proceeding appealing the SWRCB's denial of Fund claims properly be removed to the bankruptcy court; (2) assuming the Fund is entitled to sovereign immunity under the Eleventh Amendment, has the Fund waived that immunity in this case?

By order entered October 1, 1997 (the "October 1, 1997 Order"), this Court (1) reversed in part and affirmed in part the bankruptcy court's order denying the Trustee's motion for partial summary judgment in the Tax Adversary; and (2) affirmed the bankruptcy court's order denying the SWRCB's motion for abstention or remand of the Trustee's mandamus action in the Mandamus Adversary.

On September 29, 1997, the SWRCB filed its Notice of Appeal in case number CV 97-7172. In that case, the SWRCB appeals from an order entered August 28, 1997 in the Mandamus Adversary granting the Trustee's Petition for a Writ of Mandate and denying the SWRCB's Motion for Judgment on the Pleadings or in the Alternative To Limit Evidence to the Administrative Record.

On or about October 30, 1997, the SWRCB and the Fund filed with the Court of Appeals for the Ninth Circuit their Notices of Appeal of this Court's October 1, 1997 Order. Also on or about October 30, 1997, the Trustee filed a Notice of Appeal in which the Trustee appeals from that portion of the October 1, 1997 Order determining that fees paid into the Fund are taxes for purposes of bankruptcy law.

Appendix

On November 7, 1997, the SWRCB filed its Motion for Stay of Orders Pending Appeal.[1] In that Motion, the SWRCB seeks to stay all proceedings in the Mandamus Adversary and the Tax Adversary pending the resolution of the SWRCB's appeal to the Ninth Circuit. That Motion is before the Court today.

II. Discussion

The SWRCB seeks a stay of proceedings in the Tax Adversary and the Mandamus Adversary pursuant to Federal Rule of Appellate Procedure 8. Rule 8 provides that an "[a]pplication for a stay of the judgment or order of a district court pending appeal . . . must ordinarily be made in the first instance in the district court."

The parties disagree as to the standard by which this Court must determine whether to stay the proceedings. In support of the present Motion, the SWRCB cites *Goshtasby v. Board of Trustees of Univ. Of Ill.*, 123 F.3d 427, 428 (7th Cir. 1997), in which the Seventh Circuit held that a district

1. The present Motion seeks to effectuate a stay of this Court's October 1, 1997 Order in the consolidated appeals in cases number CV 96-1575 and CV 97-4724. In addition, the SWRCB seeks to stay the order of the bankruptcy court that is the subject of a bankruptcy appeal currently pending before this Court as case number CV 97-7172. This Court notes that the SWRCB failed to file separate copies of the present Motion under each of the case numbers at issue. In so doing, the SWRCB has created a great deal of administrative inconvenience for this Court, which keeps separate files for each case. Future failure by the SWRCB to comply with the Local Rules regarding presentation of documents to the Court will result in such noncomplying documents being returned to the SWRCB.

court must stay proceedings during the pendency of a nonfrivolous interlocutory appeal involving Eleventh Amendment immunity. In opposition to the present Motion, the Trustee argues that the proper standard is the general standard under Federal Rule of Appellate Procedure 8, which looks to (1) the strength of the appellant's position on appeal; (2) the irreparable injury risked by denial of a stay; (3) whether the stay would substantially harm other parties to the litigation; and (4) that the public interests favor a stay. *Securities Investor Protection Corp. v. Blinder, Robinson & Co.*, 962 F.2d 960 (10th Cir. 1992).

This Court agrees with the SWRCB. The parties agree that the Ninth Circuit may properly consider whether the Fund and the SWRCB are entitled to claim Eleventh Amendment sovereign immunity.[2] In *Goshtasby*, the Seventh Circuit held that a nonfrivolous interlocutory appeal from a denial of sovereign immunity required a district court to stay proceedings pending resolution of the appeal on its merits. *Goshtasby*, 123 F.3d at 428-29. The facts in Goshtasby thus bear a striking resemblance to the case(s) at bar.

This Court finds the rationale of *Goshtasby* to be compelling. The purpose of the Eleventh Amendment is to provide the States with sovereign immunity against

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2. The Trustee correctly points out that the SWRCB's appeal of its Eleventh Amendment immunity claim is taken pursuant to the so-called "collateral order doctrine." *See Puerto Rico Aqueduct*, 506 U.S. at 147, 113 S. Ct. at 689. In light of *Goshtasby*, which also involved an appeal under the collateral order doctrine, it appears to be irrelevant to the propriety of a stay whether the SWRCB's appeal is taken under the collateral order doctrine, or as an appeal of right.

unconsented suits. *See Puerto Rico Aqueduct*, 506 U.S. at 146, 113 S. Ct. at 689, comparing public officials' claims of absolute or qualified immunity, to the sovereign immunity enjoyed by the States, the Seventh Circuit noted, "if the defendant [public official] is correct that it has immunity, its right to be free of litigation is compromised, and lost to a degree, if the district court proceeds while the appeal is pending. Just so with an appeal by a [S]tate under the [E]leventh [A]mendment." *Goshtasby*, 123 F.3d at 428. "[T]he value to the States of their Eleventh Amendment immunity, like the benefit conferred by qualified immunity to individual officials, is for the most part lost as litigation proceeds past motion practice." *Puerto Rico Aqueduct*, 506 U.S. at 145, 113 S. Ct. at 688.

In opposition to the present Motion, the Trustee argues that a stay pending possible resolution by the Ninth Circuit of the Eleventh Amendment issue will result in harm to the Trustee, since the Trustee cannot close the underlying bankruptcy actions until all pending proceedings are resolved. This Court recognizes that a stay could result in a long delay in the distribution of Estate assets. However, a final determination of the SWRCB's Eleventh Amendment claim is an essential prerequisite to making a proper, equitable distribution of those assets.

Finally, the Trustee argues that this Court should make it a condition of any stay that the SWRCB give a bond pursuant to Federal Rule of Appellate Procedure 8(b). This Court finds no reason to believe that the monies contained in the Fund will be exhausted during the pendency of the SWRCB's appeal to the Ninth Circuit. Hence, no bond should be required.

For the foregoing reasons, this Court **GRANTS** the SWRCB's Motion for Stay of Proceedings Pending Appeal. The October 1, 1997 Order of this Court is hereby stayed pending the resolution of the SWRCB's appeal of its Eleventh Amendment immunity claim. This Court further orders that all proceedings in the Mandamus Adversary, No. 96-01575, and the Tax Adversary, No. 96-02281, be similarly stayed pending the resolution of the SWRCB's appeal.

IT IS SO ORDERED.

DATED: DEC 15 1997

[stamp] DICKRAN TEVRIZIAN
Dickran Tevrizian, Judge
United States District Court

Supreme Court, U.S.
FILED
OCT 5 2001
OFFICE OF THE CLERK

No. 01-128

In The
Supreme Court of the United States

THE STATE OF CALIFORNIA, et al.,
Petitioners,
v.
GEORGE E. SCHULMAN,
Chapter 7 Trustee,
Respondent.

On Petition For A Writ of Certiorari
To the United States Court of Appeals
For the Ninth Circuit

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

Pursuant to Rule 15.6 of the Rules of the Court, Petitioners submit the following brief in reply to the Trustee's Brief in Opposition ("Opp. Brief"). The Trustee mistakenly argues that certiorari is not warranted because the Ninth Circuit opinion has not yet resolved the question presented by Petitioners. Opp. Brief at 9. This is a misreading of the Petition, as well as the law of recoupment as it applies in the context of sovereign immunity. This Court's intervention is necessary because the Ninth Circuit has indeed created a rule of waiver that threatens to nullify the constitutional protections provided by the Eleventh Amendment.

This case arises under the following circumstances. While operating their gasoline service stations, the debtors were required to pay fees into a state-administered fund (the "Fund"). The amount of fees is based on the number of gallons of fuel stored in underground tanks. Appendix to Petition for Writ of Certiorari ("Petition App."), p. 5.

The State's proof of claim in the bankruptcy proceeding sought unpaid Fund fees. The holding from *Gardner v. New Jersey*, 329 U.S. 565 (1947), would allow the Trustee to adjudicate issues relating to this claim – *i.e.*, whether the amount of fees being claimed is proper. Under the Ninth Circuit decision, however, the Trustee was also permitted to sue the State Water Resources Control Board ("State Board") regarding a matter not necessary to determine the State's entitlement to Fund fees. In this separate legal action, the Trustee is seeking a determination regarding eligibility to obtain

reimbursement from the Fund -- a matter that will not operate to defeat or diminish the State's entitlement to receive payment for unpaid fees.

Although styled as typical state law writ of mandate, the Trustee's mandamus action against the State Board ultimately seeks the payment of money from a fund in the State Treasury.[1] In attempting to minimize the necessity of certiorari, the Trustee's refrain is that the State's sovereign immunity has not been compromised because it is not yet known whether, or how much, money will be ordered paid from this fund in the State's Treasury. Opp. Brief at 11.

Petitioners do not dispute that whether "affirmative" relief is being sought against the State is one factor to consider in an analysis to determine if a recoupment claim against a State should be allowed to proceed over the State's Eleventh Amendment objection. But the question of affirmative relief is not the only element to be considered in whether to allow such an action to be heard against a nonconsenting State.

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1. The Trustee's reference to the fact that the Fund "and not the California treasury" would pay the reimbursement claims (Opp. Brief at 4) is an indirect attempt to revive an issue rejected by the bankruptcy court and the Ninth Circuit. Although the District Court had found that the Fund was not an "arm of the State," the Ninth Circuit decided otherwise, Pet. App., pp. 29-35, and the Trustee has not sought certiorari on this issue. The Fund is indeed part of the State Treasury. Moreover, the State Board – a state agency – is the sole respondent in the Trustee's mandamus action seeking to overturn the Board's decision to deny the reimbursement claims.

The purpose of the Eleventh Amendment is twofold. "The Eleventh Amendment does not exist solely in order to 'preven[t] federal-court judgments that must be paid out of a State's treasury,' . . . ; it also serves to avoid the 'indignity of subjecting a State to the coercive process of judicial tribunals at the instance of private parties.'" *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 58 (1996)(quoting *Hess v. Port Authority Trans-Hudson Corporation*, 513 U.S. 30, 48 (1994) and *Puerto Rico Aqueduct and Sewer Authority v. Metcalf & Eddy, Inc.*, 506 U.S. 139, 146 (1993)). That the Trustee is seeking relief through a petition for writ of mandate does not render the Eleventh Amendment inapplicable. The Eleventh Amendment immunity protects states from suit regardless of the nature of the relief sought. *Pennhurst State School & Hospital v. Haldeman*, 465 U.S. 89, 100 (1984).

The Trustee's discussion of further proceedings that have taken place in the bankruptcy court subsequent to that court's rejection of the State's assertion of sovereign immunity establishes that any focus on the monetary amount of the claims against the State Board is misplaced. Opp. Brief at 6. In ruling on the mandamus action -- prior to the District Court or the Ninth Circuit hearing the State's sovereign immunity appeal -- the bankruptcy court directed the State Board to hold new administrative proceedings to reconsider all of the claims for reimbursement from the Fund. More importantly, it ordered the State Board not to consider the debtors' misconduct as an eligibility criterion for payment, even though the claims were filed by the debtors pre-petition. *Id.* This type of intrusion into the State's administrative

process is as much a violation of the State's Eleventh Amendment immunity as an affirmative monetary recovery. *See Sacred Heart Hospital of Norristown v. Commonwealth of Pennsylvania (In re Sacred Heart Hospital)*, 204 B.R. 132, 139-140 (E.D.Pa. 1997), *aff'd.* 133 F.3d 237 (3rd Cir. 1998) (bankruptcy court's order directing a state agency to hold an administrative hearing and denying its single defense to the debtor's claim violated the state's sovereign immunity).

The very error in the Ninth Circuit's opinion, and the Trustee's analysis, is the conclusion that the Eleventh Amendment does not forbid a separate action against a State so long as the action is "logically related" to the State's bankruptcy claim and no determination is made as to the extent of monetary relief. This ignores the Court's limitation in *Gardner v. New Jersey*, 329 U.S. 565 (1947), that any "waiver" by filing a proof of claim is limited to "adjudication of the claim." *Gardner*, 329 U.S. at 574. The rule from *Gardner*, and the Circuits that follow *Gardner*,[2] is straightforward. Where a State files a proof of claim in a bankruptcy proceeding, the process of proof, allowance and distribution regarding that claim is not a "suit against the State" because "[n]o judgment is sought against the State." *Gardner*, 329 U.S. at 574.

The Trustee makes a passing reference to *Gardner*

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2. *Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico*, 244 F.3d 241, 244-145 (1st Cir. 2001); *Jones v. Yorke (In re Friendship Medical Center)*, 710 F.2d 1297, 1301 (7th Cir. 1983); *In re Dept. of Energy Stripper Well Exemption Litigation (Anadarko v. New Mexico)*, 956 F.2d 282, 285 (Temp.Emerg.Ct.App. 1992).

as permitting "the assertion of defenses" when a State files a proof of claim. Opp. Brief at 10. This is an admission by the Trustee that the extent of any "waiver" of sovereign immunity when the State files a claim in federal court is a defensive recoupment action. It is precisely on this point, however, that the Ninth Circuit deviates from the Circuits following *Gardner* and extends the doctrine of waiver in a manner that is unconstitutional and unwarranted.

Recoupment is a doctrine that is recognized by the courts precisely because it is in the "nature of a defense." *See Bull v. United States*, 295 U.S. 247, 262 (1935).[3] This well-established rule, as applied against a sovereign, is entirely consonant with *Gardner* Where a governmental entity seeks relief against a debtor's estate by submitting a proof of claim, the government has only "consented" to allow the court to hear matters involving the proof of, and defenses to, that claim. *Gardner*, 329 U.S. at 574.

The Ninth Circuit's opinion expressly recognized that it was adopting a rule of implied waiver of sovereign immunity beyond that allowed in *Gardner*. In authorizing

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3. The Trustee mischaracterizes the holding in *Bull v. United States*, 295 U.S. 247 (1935) as authorizing a counterclaim against a sovereign where "both claims involved taxation of proceeds from a single fund." Opp. Brief at 15. *Bull* does not stand for such a broad proposition. While the Court in *Bull* correctly recites that recoupment is "defensive" in nature, a more recent decision of the Court has emphasized that the type of equitable recoupment recognized in *Bull* "will lie only where the Government has taxed a single transaction, item, or taxable event under two inconsistent theories." *United States v. Dalm*, 494 U.S. 596, 605 n.5 (1990). The Trustee herein is not alleging inconsistent or contradictory theories of taxation.

a claim to be asserted against the State solely because that claim is "logically related" to the State's claim for unpaid taxes and fees, the Ninth Circuit set forth a "broader waiver" rule than set forth in *Gardner*. Petition App., pp. 18-19.

> Although the waiver found constitutional in *Gardner* was limited to the state's own claim, and thus narrower than the same-transaction-or-occurrence standard, ...

Petition App., p. 18.

Stated succinctly, *Gardner* represents a proper recoupment analysis because it narrowly limits any "waiver" of sovereign immunity to adjudicating and defending against the State's claim. The Ninth Circuit's opinion holds that if a separate action against the State is "logically related" to the State's bankruptcy claim, the Eleventh Amendment does not require that it be defensive in nature. Such a ruling overlooks the fact that by ignoring the requirements of defensive recoupment and extending *Gardner* to find a "broad waiver" of sovereign immunity, the Circuit has placed itself in clear conflict with this Court's Eleventh Amendment jurisprudence.

The Trustee seeks to find some inconsistency between the question presented in the Petition and the position taken by the State at the Ninth Circuit -- *i.e.*, "when the State files a proof of claim, it does consent to the bankruptcy court determining a recoupment claim arising out of the 'same transaction or occurrence' as the State's proof of claim." *See* Opp. Brief at 13. There is no

inconsistency here. An acknowledgment by the State that an allowable defensive recoupment claim must arise out of the "same transaction or occurrence" is not an admission that such a claim need not satisfy the more primary standard of being defensive in nature. As our Opening Brief before the Ninth Circuit pointed out:

> Regardless of whether the mandate petition is deemed to arise out of the "same transaction or occurrence," the bankruptcy court cannot grant relief to the Trustee because, by definition, the mandate petition is not in the nature of a defensive recoupment action.

Opening Brief of Appellants California State Water Resources Control Board *et al.* at 42.

The Ninth Circuit improperly found a broad waiver of the Eleventh Amendment when it applied an "increasingly liberal" standard to the "same transaction or occurrence" test. *See College Savings Bank v. Florida Prepaid Postsecondary Education Expense Bd.*, 527 U.S. 666, 675 (1999) (the test for waiver is a "stringent" one). This was not its only error of constitutional dimension, however. It made a far greater incursion into the States' sovereign immunity when it rejected the rule established by the Court in *Gardner*, a rule that is consistent with the parameters of proper defensive recoupment. By definition, and as applied by the bankruptcy court, the Trustee's mandamus action is not "defensive" in any sense of the word.

As Montana and the other states and territories that have supported the Petition recognize in their amicus brief:

> State revenue departments routinely file proofs of claim in bankruptcy to collect unpaid taxes. As this Court has noted, "[t]he power to tax 'is an incident of sovereignty. . . .'"

Brief of Amicus Curiae States of Montana, *et al.* at 1-2 (citing *International Harvester Co. v. Wisconsin Dept. of Taxation*, 322 U.S. 435, 444 (1944)). The Ninth Circuit opinion subjects a state agency to a suit that is not defensive in nature, solely because the state revenue-collecting entity has sought to recover unpaid taxes. This is impermissible under the Eleventh Amendment because it is a "deemed" waiver of sovereign immunity "implied" from the exercise of sovereign functions – *i.e.*, the right to impose and collect taxes.

If allowed to stand, the Ninth Circuit's opinion with respect to waiver will allow States to be sued for any cause of action that has any arguable relationship to the State's demand for unpaid taxes. Such a rule would dilute the constitutional protections inherent in the Eleventh Amendment. In contrast, the narrow holding in *Gardner* is consistent with the Court's Eleventh Amendment jurisprudence, which rejects the concept of an implied or constructive waiver of sovereign immunity. The intervention of the Court is necessary to establish a uniform rule on this important question.

CONCLUSION

The petition for writ of certiorari should be granted.

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